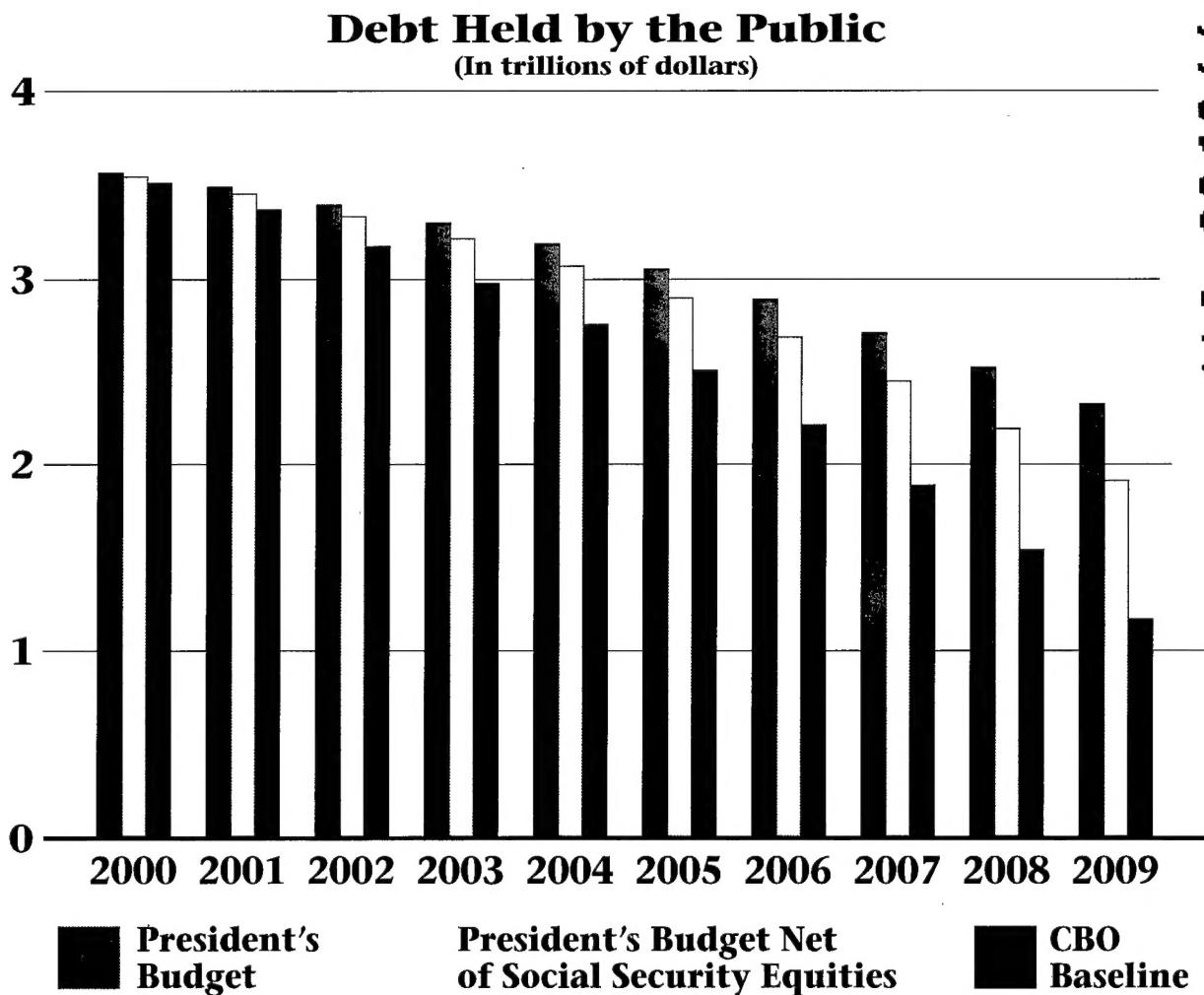


An Analysis of the President's Budgetary Proposals for Fiscal Year 2000

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SENATE COMMITTEE ON APPROPRIATIONS



APRIL 1999

**AN ANALYSIS OF THE PRESIDENT'S
BUDGETARY PROPOSALS
FOR FISCAL YEAR 2000**

The Congress of the United States
Congressional Budget Office

NOTES

Numbers in the text and tables of this report may not add to totals because of rounding.

Unless otherwise indicated, all years referred to in Chapter 5 are calendar years, and all years in other chapters and the appendixes are fiscal years.

The figures in Chapter 5 indicate periods of recession by using shaded vertical bars. The bars extend from the peak to the trough of the recession.

Unemployment rates throughout the report are calculated on the basis of the civilian labor force.

Preface

This analysis of the President's budget for fiscal year 2000 was prepared at the request of the Senate Committee on Appropriations. It was produced by the staffs of the Budget Analysis, Macroeconomic Analysis, and Tax Analysis divisions under the supervision of Paul Van de Water, Robert Dennis, and Thomas Woodward. Authors contributing to this volume include Linda Bilheimer, Thomas Bradley, Kent Christensen, Paul Cullinan, Jeff Holland, James Horney, Richard Kasten, Marjorie Miller, Michael Miller, John Peterson, Paul Van de Water, and Jennifer Winkler. James Horney coordinated the effort. The estimates of the President's revenue proposals were prepared by the Joint Committee on Taxation. The principal contributors to the revenue and spending estimates and analyses are listed in Appendix C.

Major portions were edited by Leah Mazade, Sherry Snyder, Christian Spoor, and Liz Williams. The authors owe thanks to Marion Curry, Linda Harris, Dorothy Kornegay, and Wanda Sivak, who assisted in producing sections of the report. Kathryn Quattrone prepared the report for publication, and Laurie Brown prepared the electronic versions for CBO's World Wide Web site, both assisted by Martina Wojak-Piotrow.

Dan L. Crippen
Director

April 1999

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Summary

As requested by the Senate Committee on Appropriations, the Congressional Budget Office (CBO) has estimated the effects of the President's budgetary proposals for fiscal year 2000 using its own economic and technical assumptions.

The President's Budgetary Policies

Robust economic growth in the recent past and the prospect of continued growth for the foreseeable future have produced a favorable fiscal outlook. Total budget surpluses are now projected until well into the next century. The positive outlook arises because under current tax and spending policies, revenues are expected to grow at an average annual rate of 4.2 percent over the next decade compared with a projected 3.2 percent rate of growth for outlays.

Budgeting is a process of establishing priorities in the context of limited resources. It may seem that the existence of surpluses eases the restraint of limited resources and reduces the necessity for comprehensive budgeting. Neither is the case. The projected surpluses are, at best, temporary because the approaching retirement of the baby boomers will ultimately turn surpluses into deficits. Even under the most favorable conditions, Social Security and Medicare will consume ever-larger proportions of the federal budget.

In both the near and long term, choices must be made. The projected surpluses can be used for only three purposes: they can be saved (that is, used to pay

down debt held by the public), spent on government programs, or used to reduce taxes. Over the next 10 years, the President proposes to save approximately two-thirds of the surpluses, spend a little more than the remainder, and finance the extra spending by a net increase in taxes.

CBO traditionally measures the impact of the President's budget by comparing the financial outcome of his proposals to the budget baseline, which assumes that current policies and laws are unchanged. Under the baseline, the cumulative total budget surpluses over the next 10 years will amount to \$2.6 trillion, nearly all of which would be used to reduce the debt held by the public. By CBO's estimates, the President's budget proposes, instead, to save 55 percent, or \$1.4 trillion, of the projected surplus over the next 10 years.¹ Of the remaining \$1.2 trillion, \$0.9 trillion would be spent on government programs and \$0.3 trillion would be used to purchase private equities to be held by the Social Security trust funds.

Both the reductions in the debt held by the public and the proposed purchases of private equities (\$0.3 trillion) would increase national savings. That net reduction in liabilities, therefore, represents another measure of the amount of the federal budget surpluses that are "saved." Using that measure, CBO estimates that the President's budget would save 66 percent, or \$1.7 trillion, of the projected surplus over the next 10 years.

1. Another way to determine how much of the surplus is saved is to compare the proposed changes in debt held by the public both with and without the proposed policies, but the percentage difference is almost the same.

That amount, however, is less than the \$1.8 trillion baseline Social Security surplus. Since the proposed policies would not save the entire Social Security surplus, they would also not provide any savings that could be made available for Medicare.

The mechanism by which the President proposes to save the surplus is a transfer of nonmarketable Treasury securities to both the Social Security and the Medicare Hospital Insurance trust funds. Under conventional budgeting rules, the transfers themselves have no effect on the surplus. The President proposes, instead, a fundamental revision of how spending is measured and reflected in the federal budget. The change in decades-old budget concepts would have the effect of eliminating the surpluses that would be reported under traditional budgetary accounting. The rationale for such an accounting change has been articulated as increasing the likelihood that the surplus will be "saved." If implemented, such an accounting change could be reversed in the future, although embedding the mechanism in the popular programs of Social Security and Medicare could make such a reversal more difficult. In any event, surpluses will ultimately be saved only if future Administrations and Congresses do not use them to expand spending or cut taxes—not by accounting changes.

With or without the accounting change, the proposed transfers would extend the dates of insolvency of the Social Security and Hospital Insurance trust funds. In the absence of any other action, the transfers would not alter the fact that higher taxes or lower government spending will eventually be required. According to the Administration, the commitment of future general funds would be sufficient to eliminate approximately one-half of the long-run shortfall in the Social Security system.

However, extending the projected life of the trust funds neither requires nor guarantees that the surpluses are actually saved. The President's budget recognizes that the trust fund balances do not consist of assets in a bank account, to be drawn down in future times of need:

These balances are available to finance future benefit payments and other trust fund expenditures—but only in a bookkeeping sense. These funds are not set up to be

pension funds, like the funds of private pension plans. They do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures. The existence of large trust fund balances, therefore, does not, by itself, have any impact on the Government's ability to pay benefits.²

As with previous budgets—from this and other Administrations—many of the more difficult policy choices in the fiscal year 2000 budget are unspecified or left for the future. Although the President recognizes the need to reform Social Security and Medicare, he does not include proposals for either. He endorses expansions of benefits for both programs without specifying either the policy or how to pay for them. Despite embracing the concept of saving the Social Security surplus, the President's budget does not propose to save all of it until sometime after 2009.

More immediately, the President proposes to increase discretionary spending for 2000 significantly above the amounts allowed under the statutory caps on such spending. CBO estimates that the President's proposals would exceed the statutory caps on discretionary spending by \$30 billion in 2000, some of which he proposes to offset by increasing revenues and cutting spending in mandatory programs such as Medicare. Discretionary outlays under the President's proposals would increase as a percentage of gross domestic product in 2000 but would decline in succeeding years.

The Administration describes its request for national defense as a substantial increase in funding compared with that proposed in last year's budget. But compared with the CBO baseline that projects the 1999 funding level (including emergency appropriations) adjusted for inflation, its request represents a decrease. In addition, CBO estimates that outlays under the President's budget for defense programs in

2. *Budget of the United States Government, Fiscal Year 2000: Analytical Perspectives*, p. 337.

2000 will be nearly \$10 billion higher than the Administration estimates.

for 2000) that are to be enacted whether or not agreement is reached on reforming Social Security;

CBO's Estimates of the President's Proposals

The proposals in the fiscal year 2000 budget fall into three categories:

- o A group of basic policy proposals (including recommended levels of discretionary appropriations

- o Proposals that are contingent on adopting what the President calls his framework for Social Security reform; and
- o Additional proposals that are mentioned in the budget submission or the State of the Union address but are not included in the budget numbers.

Although a few of the estimates in the President's budget extend for 15 years, the Administration provides

Summary Table 1.
CBO Estimate of the Effect on the Surplus of the President's Budgetary Policies
(By fiscal year, in billions of dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-2004
Baseline Total Budget Surplus ^a	111	133	156	212	213	239	263	309	338	358	383	952
Effect on the Surplus of the President's Budgetary Policies Excluding Social Security Framework Proposals ^b	<u>-1</u>	<u>-20</u>	<u>-7</u>	<u>-14</u>	<u>-17</u>	<u>-15</u>	<u>-7</u>	<u>-2</u>	<u>c</u>	<u>-5</u>	<u>-4</u>	<u>-73</u>
Surplus Under the President's Budgetary Policies Excluding Social Security Framework Proposals	109	113	149	198	196	224	255	307	338	353	379	880
Effect on the Surplus of the President's Social Security Framework Proposals ^d	<u>0</u>	<u>-32</u>	<u>-60</u>	<u>-88</u>	<u>-87</u>	<u>-96</u>	<u>-109</u>	<u>-131</u>	<u>-146</u>	<u>-156</u>	<u>-171</u>	<u>-364</u>
Surplus or Deficit (-) Under the President's Budgetary Policies Including Social Security Framework Proposals												
Total Budget	109	80	89	110	109	128	146	176	192	198	208	516
On-budget	-17	-126	-116	-124	-137	-146	-156	-166	-189	-223	-251	-648
Off-budget	127	206	205	234	245	274	301	342	381	421	459	1,164

SOURCE: Congressional Budget Office.

- a. Assumes that discretionary spending will equal the statutory caps on such spending in 2000 through 2002 and will increase at the rate of inflation thereafter.
- b. See Chapter 1 for details.
- c. Less than \$500 million.
- d. See Chapter 2 for details.

no details about its policies after 2009. Likewise, CBO's analysis covers 10 years.

CBO estimates that the Administration's budget—including both the basic policies and the Social Security framework—would reduce projected surpluses by \$53 billion in 2000 and a total of \$436 billion through 2004. Those figures do not include the additional proposals that the Administration has not clearly specified.

Under its basic policies, the Administration would increase discretionary spending above the levels allowed by the current statutory caps on such spending. It would pay for that increase by raising revenues and cutting mandatory spending. CBO estimates, however, that the increase in discretionary spending

would be only partly offset by the higher revenues and lower mandatory spending. In 2000, the basic policies would reduce the surplus by \$20 billion compared with CBO's current-policy projections (see Summary Table 1). Over the 2000-2004 period, the Administration's basic policies would reduce the projected surpluses by a total of \$73 billion.

The President's budget also contains several proposals that are contingent on a legislative agreement to delay the insolvency of the Social Security trust funds. Those proposals include further increasing defense and nondefense discretionary spending, subsidizing new Universal Savings Accounts, making transfers from the general fund to the Social Security and Medicare trust funds, and using about one-fifth of the transfers to Social Security to purchase corporate stock. In

Summary Table 2.

CBO Estimate of Debt Held by the Public and Corporate Stock Held by Social Security Under the President's Budgetary Policies Including the Social Security Framework (By fiscal year, in billions of dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Federal Debt Held by the Public Under CBO's Baseline Projections	3,628	3,512	3,372	3,176	2,979	2,756	2,508	2,212	1,886	1,540	1,168
Effect of the President's Budgetary Policies on Federal Debt Held by the Public	<u>1</u>	<u>53</u>	<u>119</u>	<u>220</u>	<u>323</u>	<u>432</u>	<u>548</u>	<u>679</u>	<u>823</u>	<u>982</u>	<u>1,155</u>
Federal Debt Held by the Public Under the President's Budgetary Policies	3,630	3,565	3,491	3,396	3,302	3,189	3,055	2,891	2,710	2,522	2,324
Value of Corporate Stock Held by Social Security Under the President's Budgetary Policies	<u>0</u>	<u>19</u>	<u>36</u>	<u>60</u>	<u>85</u>	<u>118</u>	<u>156</u>	<u>204</u>	<u>262</u>	<u>331</u>	<u>413</u>
Federal Debt Held by the Public Net of Corporate Stock Held by Social Security	3,630	3,546	3,455	3,336	3,217	3,071	2,899	2,687	2,448	2,191	1,911
Memorandum: Net Change in Debt Held by the Public and Corporate Stock Held by Social Security	1	35	83	161	238	314	392	475	562	651	742

SOURCE: Congressional Budget Office.

NOTE: All amounts refer to debt or stock held at the end of the fiscal year.

total, those policies (the President's Social Security framework) would reduce the surplus by another \$32 billion in 2000, more than \$360 billion over the 2000-2004 period, and almost \$1.1 trillion over the next 10 years.

Because the transfers from the general fund to the Social Security trust funds would be intragovernmental, they would have no effect on total federal spending, revenues, or surpluses. They would, however, delay the projected date on which the Social Security trust funds will become insolvent. The Administration estimates that its Social Security framework would postpone the exhaustion of those trust funds from 2032 to 2055. CBO is unable to confirm that claim, however.

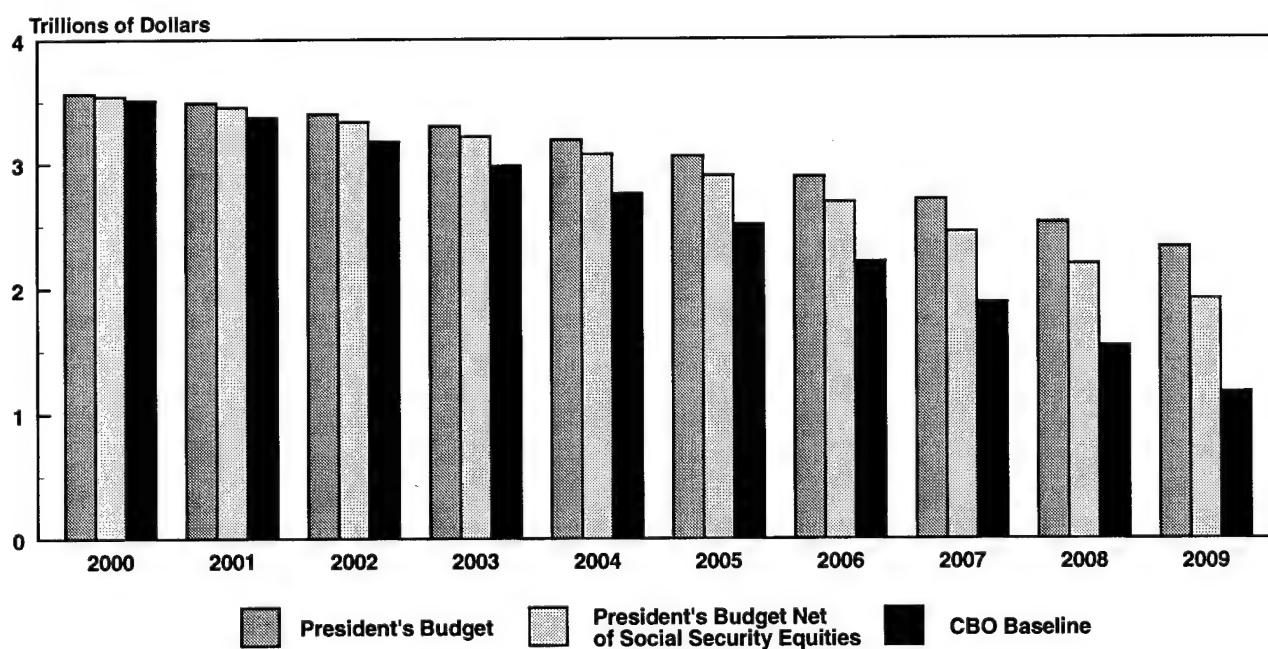
The President's proposals include various changes to the Medicare program, some of which would extend coverage to new groups of people and others of which would reduce spending. Overall, CBO estimates, the President's basic Medicare policies would save about \$9 billion in mandatory spending

through 2004 and \$19 billion through 2009. As for recent trends in the program, CBO believes that last year's dramatic slowdown in the growth rate of Medicare spending will prove temporary. It projects that spending will grow at an annual rate of more than 7 percent over the next decade.

In the area of national defense, the President's budget calls for increasing pay and benefits for military personnel and spending more on weapons procurement, among other changes. Those proposals would increase the defense budget by a total of \$112 billion over the next six years compared with the Administration's request of a year ago. However, the President's proposals would produce a decline in funding compared with the CBO baseline that projects the 1999 funding level (including emergency appropriations) adjusted for inflation.

The economic assumptions that underlie the President's budget are similar to those of CBO through 2004. Both CBO and the Administration are projecting much slower economic growth in 1999 and 2000

Summary Figure 1.
Debt Held by the Public



SOURCE: Congressional Budget Office.

NOTE: All amounts refer to debt or stock held at the end of the fiscal year.

than in recent years (as are most private-sector forecasters). They are also projecting little change in interest rates in the short run. CBO's economic assumptions result in higher projections of both revenues and outlays than the Administration's assumptions do, but the budgetary effects of those projections are largely offsetting. Thus, differences in economic assumptions account for little of the difference between CBO's and the Administration's projections of the budget surplus.

In conjunction with its analysis of the President's budget, CBO has updated its estimates of revenues and outlays under current policies. Under the baseline scenario, CBO estimates that annual surpluses will rise from \$111 billion this year to \$383 billion 10 years from now. If such surpluses materialize, they will equal nearly 3 percent of gross domestic product by 2009.

To the extent that the federal government runs budget surpluses, it can pay down the amount of federal debt held by the public. CBO projects that under current laws and policies, debt held by the public would decline from \$3.6 trillion at the end of 1999 to \$1.2 trillion in 2009 (see Summary Table 2 and Summary Figure 1). Under the President's policies, by contrast, debt held by the public would decline only to

an estimated \$2.3 trillion in 2009. At that point, debt held by the public minus Social Security's holdings of corporate stock would total \$1.9 trillion, or nearly \$750 billion more than in CBO's baseline. The estimated reduction in debt held by the public under the President's policies amounts to 53 percent of the reduction that CBO estimates would result if current policies remained the same. Adjusting for the value of the corporate stock that Social Security would hold, the drop in debt held by the public would equal 70 percent of the baseline reduction.

The Administration indicates that it will work with the Congress to develop additional proposals to keep Social Security solvent for the next 75 years. In the context of those changes, the President has expressed a desire to eliminate Social Security's retirement earnings test and to reduce the poverty rate among elderly widows and other groups of elderly people. In his State of the Union message, the President also suggested adding a prescription drug benefit to Medicare. Because the Administration has not provided any detailed description of those additional proposals, CBO cannot estimate how much they would cost. Consequently, they are not included in this analysis.

The President's Basic Policy Proposals

The basic spending policies proposed in the President's budget for 2000 (excluding proposals that are contingent on adoption of Social Security reform) would boost outlays by a net \$124 billion over the 2000-2004 period, the Congressional Budget Office (CBO) estimates.¹ Over the same period, the President's basic policies would increase revenues by \$52 billion. Nearly all of the increase in outlays, \$116 billion, would result from higher discretionary spending—the one-third of federal spending that is subject to annual appropriations by the Congress.

Under the President's proposals, total discretionary spending will increase above the levels allowed under the existing statutory caps on such spending. The budget proposes increases in revenues and reductions in mandatory spending that the Administration claims are sufficient to offset the growth in discretionary spending. However, CBO estimates that the Administration's revenue and mandatory spending savings are not large enough to offset the reduction in the surplus caused by the increases in discretionary outlays. Furthermore, under current law, the proposed savings would not count as offsets for determining compliance with the discretionary caps.

The President's request for discretionary appropriations will result in outlays that exceed the existing statutory caps by almost \$33 billion in 2000 alone, according to CBO's estimate (see Table 1-1). Under CBO's assumptions, the proposed policy changes affecting revenues and mandatory spending will offset

less than \$13 billion of the increase in discretionary spending in 2000. Thus, the surplus will decline relative to CBO's baseline by \$20 billion in that year. Net changes in revenues and mandatory spending will offset an estimated \$44 billion of the \$116 billion discretionary increase relative to CBO's baseline in 2000 through 2004, producing a cumulative reduction in the surplus of \$73 billion over that period.

Spending Proposals

Under the President's budget excluding the Social Security framework proposals, CBO estimates that federal spending would rise from \$1.7 trillion in 1999 to nearly \$2.0 trillion in 2004, an average increase of 2.9 percent a year. (The proposals in what the President calls his framework for Social Security reform are contingent on a legislative agreement that would extend the life of the Social Security trust funds. See Chapter 2 for levels of spending under the President's budget including those proposals.) As a share of gross domestic product (GDP), outlays would decline from 19.5 percent in 1999 to 18.2 percent in 2004 (see Table 1-2).

Most of the decline in spending as a percentage of GDP is a result of declining net interest costs and relatively slow growth in discretionary spending. The government's net interest expenses are projected to fall as budget surpluses permit the debt held by the public to be paid down. Discretionary spending also declines between 1999 and 2004 as a percentage of GDP, but only after increasing slightly in 2000. Mandatory spending other than net interest—primarily for Medi-

1. That figure is relative to CBO's baseline, which assumes that current laws remain unchanged and that discretionary outlays are held to the levels of the existing spending caps for 2000 through 2002 and grow at the rate of inflation thereafter.

care and Medicaid—would continue to rise as a share of the nation's output.

Discretionary Spending

The President's request for discretionary budget authority for fiscal year 2000 totals \$564 billion—\$282 billion for defense and \$282 billion for nondefense programs (see Table 1-3). (The Administration is also requesting approximately \$34 billion in obligation lim-

its that control spending for discretionary transportation programs but do not count as budget authority.) Although the requested budget authority is \$3 billion below the inflation-adjusted 1999 level of total appropriations excluding funding for emergencies and the International Monetary Fund (IMF), CBO estimates that outlays would be \$7 billion higher (about \$2.5 billion in defense and around \$4.5 billion in nondefense programs) than the outlays that would result from providing an appropriation for each account equal to the 1999 appropriation adjusted for inflation.

Table 1-1.
Comparison of CBO's Baseline with Its Estimate of the President's Budget Excluding the Social Security Framework (By fiscal year, in billions of dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-2004	2000-2009
Baseline													
Revenues	1,815	1,870	1,930	2,015	2,091	2,184	2,288	2,393	2,500	2,611	2,727	10,090	22,607
Outlays													
Discretionary	574	573	573	568	583	598	614	630	646	663	680	2,894	6,127
Mandatory	1,130	1,164	1,202	1,234	1,295	1,347	1,411	1,454	1,516	1,590	1,664	6,243	13,878
Subtotal	1,704	1,737	1,775	1,802	1,878	1,946	2,025	2,083	2,162	2,253	2,344	9,137	20,004
Surplus	111	133	156	212	213	239	263	309	338	358	383	952	2,603
Estimate of the President's Budget Excluding Social Security Framework Proposals													
Revenues	1,814	1,881	1,941	2,025	2,101	2,194	2,298	2,400	2,507	2,620	2,737	10,141	22,703
Outlays													
Discretionary	575	605	590	590	606	619	628	636	649	673	689	3,011	6,286
Mandatory	1,129	1,163	1,203	1,236	1,299	1,350	1,415	1,457	1,520	1,594	1,669	6,251	13,906
Subtotal	1,705	1,768	1,792	1,827	1,905	1,970	2,043	2,093	2,169	2,267	2,358	9,262	20,191
Surplus	109	113	149	198	196	224	255	307	338	353	379	880	2,512
Difference													
Revenues	a	11	11	11	10	9	10	7	7	9	10	52	96
Outlays													
Discretionary	1	33	17	22	23	21	14	6	3	10	9	116	159
Mandatory	-1	-1	a	2	4	3	3	4	4	4	5	8	28
Subtotal	1	31	18	25	27	24	18	10	7	14	14	124	187
Surplus	-1	-20	-7	-14	-17	-15	-7	-2	a	-5	-4	-73	-91

SOURCE: Congressional Budget Office.

a. Less than \$500 million.

Table 1-2.
CBO Reestimate of the President's Budget Excluding the Social Security Framework (By fiscal year)

	Actual 1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
In Billions of Dollars												
Revenues	1,722	1,814	1,881	1,941	2,025	2,101	2,194	2,298	2,400	2,507	2,620	2,737
On-budget	1,306	1,368	1,413	1,453	1,519	1,573	1,644	1,721	1,798	1,879	1,965	2,056
Off-budget	416	446	468	488	506	527	550	577	602	628	654	681
Outlays												
Discretionary spending	555	575	605	590	590	606	619	628	636	649	673	689
Mandatory spending	939	978	1,026	1,083	1,141	1,211	1,279	1,364	1,427	1,514	1,613	1,715
Offsetting receipts	-84	-78	-82	-89	-101	-97	-102	-109	-114	-121	-128	-136
Net interest	243	229	218	208	197	185	173	160	144	128	109	90
Total	1,653	1,705	1,768	1,792	1,827	1,905	1,970	2,043	2,093	2,169	2,267	2,358
On-budget	1,336	1,385	1,438	1,449	1,474	1,539	1,591	1,650	1,685	1,745	1,825	1,895
Off-budget	317	320	330	343	353	366	379	393	408	424	441	463
Deficit (-) or Surplus	69	109	113	149	198	196	224	255	307	338	353	379
On-budget	-30	-17	-25	4	45	34	53	71	113	134	140	160
Off-budget	99	127	138	145	153	162	171	184	194	204	213	218
Debt Held by the Public	3,720	3,629	3,532	3,399	3,215	3,035	2,825	2,582	2,287	1,960	1,617	1,247
As a Percentage of GDP												
Revenues	20.5	20.7	20.7	20.5	20.4	20.3	20.2	20.3	20.2	20.2	20.2	20.2
On-budget	15.5	15.6	15.5	15.3	15.3	15.2	15.2	15.2	15.2	15.2	15.2	15.2
Off-budget	4.9	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.0
Outlays												
Discretionary spending	6.6	6.6	6.7	6.2	6.0	5.9	5.7	5.5	5.4	5.2	5.2	5.1
Mandatory spending	11.2	11.2	11.3	11.4	11.5	11.7	11.8	12.0	12.0	12.2	12.5	12.7
Offsetting receipts	-1.0	-0.9	-0.9	-0.9	-1.0	-0.9	-0.9	-1.0	-1.0	-1.0	-1.0	-1.0
Net interest	2.9	2.6	2.4	2.2	2.0	1.8	1.6	1.4	1.2	1.0	0.8	0.7
Total	19.7	19.5	19.4	18.9	18.4	18.4	18.2	18.0	17.7	17.5	17.5	17.4
On-budget	15.9	15.8	15.8	15.3	14.9	14.9	14.7	14.6	14.2	14.1	14.1	14.0
Off-budget	3.8	3.6	3.6	3.6	3.6	3.5	3.5	3.5	3.4	3.4	3.4	3.4
Deficit (-) or Surplus	0.8	1.2	1.2	1.6	2.0	1.9	2.1	2.3	2.6	2.7	2.7	2.8
On-budget	-0.4	-0.2	-0.3	a	0.5	0.3	0.5	0.6	1.0	1.1	1.1	1.2
Off-budget	1.2	1.4	1.5	1.5	1.5	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Debt Held by the Public	44.3	41.4	38.8	35.9	32.5	29.3	26.1	22.8	19.3	15.8	12.5	9.2
Memorandum:												
Gross Domestic Product (Billions of dollars)	8,404	8,762	9,095	9,476	9,904	10,358	10,837	11,337	11,855	12,391	12,946	13,521

SOURCE: Congressional Budget Office.

NOTE: For revenues and outlays under the President's budgetary policies including the Social Security framework proposals, see Table 2-3 on page 26.

a. Less than 0.05 percent.

Table 1-3.
**CBO Estimate of the President's Discretionary Spending Proposals for Fiscal Year 2000
Compared with Various Benchmarks (In billions of dollars)**

	Including Amounts for 1999 Emergencies	Excluding Amounts for 1999 Emergencies ^a
Budget Authority		
CBO Estimate of Discretionary Spending in the President's Budget	564	564
Amount to Preserve 1999 Real Resources		
Defense	290	281
Domestic and international ^b	287	279
Violent crime reduction	6	6
Mass transit	<u>1</u>	<u>1</u>
Total	583	567
Budget minus amount to preserve 1999 real resources	-19	-3
Amount to Freeze 1999 Dollar Resources ^c		
Defense	281	273
Domestic and international ^b	275	267
Violent crime reduction	6	6
Mass transit	<u>1</u>	<u>1</u>
Total	563	547
Budget minus amount to freeze 1999 dollar resources	1	17
Outlays		
CBO Estimate of Discretionary Spending in the President's Budget	605	605
Amount to Preserve 1999 Real Resources		
Defense	286	282
Domestic and international	284	281
Violent crime reduction	5	5
Highways	25	25
Mass transit	<u>5</u>	<u>5</u>
Total	605	598
Budget minus amount to preserve 1999 real resources	d	7
Amount to Freeze 1999 Dollar Resources ^c		
Defense	280	276
Domestic and international	279	277
Violent crime reduction	5	5
Highways	25	25
Mass transit	<u>5</u>	<u>5</u>
Total	594	587
Budget minus amount to freeze 1999 dollar resources	11	18

SOURCE: Congressional Budget Office.

- a. In 1999, \$16 billion in appropriations was designated as emergency spending. The totals here exclude the estimated budget authority and outlays that result from assuming that those appropriations are repeated in 2000.
- b. In 1999, an appropriation of \$18 billion was provided for the International Monetary Fund to meet a periodic commitment for which funding was last provided in 1993. Such appropriations result in no outlays. The domestic and international totals here exclude the estimated budget authority that results from assuming that the appropriation is repeated in 2000.
- c. Amounts to freeze 1999 dollar resources include no adjustment for inflation.
- d. Less than \$500 million.

The outlays resulting from the President's plan would be \$18 billion higher than those that would result from freezing discretionary budget authority at the 1999 dollar level in 2000 (excluding emergency and IMF funding), with the excess equally divided between defense and nondefense programs.

After taking into account adjustments to the caps (primarily for emergency appropriations) that would be required under current law if the President's proposals were enacted, CBO estimates that the President's discretionary spending in 2000 would exceed the caps by \$22 billion in budget authority and \$30 billion in outlays (see Table 1-4). The President pro-

poses to change current rules to allow a number of revenue and mandatory spending proposals to count as offsets to discretionary spending (see Box 1-1). Under the Administration's assumptions, those offsets would keep discretionary spending from exceeding the caps. CBO, however, estimates that discretionary spending would still exceed the cap for budget authority by \$5 billion and the cap for outlays by \$14 billion.

In all, the discretionary budget authority that the President proposes for 2000 is \$9 billion, or 1.6 percent, higher than the amount enacted for 1999 (see Table 1-5). However, the 1999 levels include almost \$16 billion in budget authority designated as emer-

Table 1-4.
Discretionary Caps and Proposed Spending for Fiscal Year 2000 (In billions of dollars)

	CBO Estimate		Administration Estimate		CBO Minus Administration	
	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays
Baseline Caps ^a	537	573	538	574	-1	-2
Adjustments Under Current Law If President's Proposals Are Enacted	—5	—3	—b	—b	—5	—3
Caps with Current-Law Adjustments	542	575	538	574	4	1
President's Budget Request ^a	564	605	556	592	8	14
President's Budget Request Minus Baseline Caps	27	33	18	17	9	16
President's Budget Request Minus Adjusted Caps	22	30	18	17	4	13
Offsets That Would Require a Change in Law	-17	-17	-18	-18	1	1
President's Budget Request Net of Offsets	547	589	538	574	9	15
President's Budget Request Net of Offsets Minus Adjusted Caps	5	14	c	-1	5	14

SOURCES: Congressional Budget Office; Office of Management and Budget.

a. Includes an upward adjustment for mass transit budget authority that is not subject to the caps.

b. The Administration's baseline caps include adjustments that the Administration assumes will be made if the President's proposals are enacted.

c. Less than \$500 million.

gency spending. If the emergency budget authority is removed from the enacted 1999 level, the President's request for 2000 is \$21 billion, or 4.0 percent, above the previous year's appropriation.

The largest proposed increase in budget authority is for education and training. Under the President's budget, such programs would receive \$5.6 billion more in budget authority in 2000 than they received in 1999. Most of that jump, however, is simply the result of a change in the timing of appropriations for grants to local education agencies to improve academic performance and to target high-poverty schools.

By CBO's estimate, outlays in 2000 under the President's basic proposals would be \$31 billion, or 5.4 percent, higher than in the current year. Outlays for national defense are projected to rise by \$10 bil-

lion, mostly as a result of spending from appropriations (including emergencies) enacted in prior years. A variety of other budget functions are projected to show increases in outlays, also, in part, because of the spendout of previously enacted budget authority.

Mandatory Spending

Proposed changes in mandatory programs would reduce outlays by \$1 billion in 2000 but increase them by \$8 billion over the 2000-2004 period (see Table 1-6). Additional funding for child care (\$1 billion in 2000 and \$9 billion in 2000 through 2004) represents the budget's largest proposed increase in mandatory spending. Proposed changes in Medicaid would increase spending by \$1 billion a year by 2003. Propos-

Box 1-1. Offsets to Discretionary Spending in Fiscal Year 2000 Proposed in the President's Budget

The President's budget proposes offsets to discretionary spending in 2000 that would require a change in rules to be so counted. The proposed offsets, as estimated by the Congressional Budget Office, are the following:

- o Savings of \$2 billion in direct spending programs (including \$1.1 billion for Medicare) that would be enacted in authorizing legislation. Under current rules, savings in direct spending count as offsets to discretionary spending only if they are enacted in appropriation acts.
- o A \$1 billion increase in offsetting receipts to the Military Retirement Trust Fund, the result of changes in military retirement benefits. Under current rules, such increases are not counted as savings in either direct or discretionary spending because the increase in receipts reflects an increase in the long-term liabilities of the trust fund.
- o An \$11 billion increase in revenues that would be enacted in bills other than appropriation acts.

CBO believes that current rules do not allow revenue changes to be counted as offsets to discretionary spending under any circumstance, although the Administration has so counted them when they are enacted in an appropriation act.

- o The elimination of the current \$3 billion pay-as-you-go balance for fiscal year 2000. Under current rules, eliminating the balance would not be counted as either direct or discretionary spending because that balance does not directly affect budget authority or outlays.

The Administration estimates that these items would offset \$18 billion in discretionary outlays. CBO estimates that under current rules they would not offset discretionary spending at all. Assuming that the rules were changed to allow the items to count as offsets, CBO estimates that they would total \$17 billion and that net discretionary spending proposed by the President would exceed the adjusted Balanced Budget and Emergency Deficit Control Act limits on outlays by \$14 billion.

Table 1-5.
**CBO Estimate of the President's Discretionary Spending Proposals, by Budget Function
(By fiscal year, in billions of dollars)**

Function	1999 (Enacted)		2000 (Proposed)		Change from 1999 to 2000	
	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays
National Defense	280.1	274.2	281.7	284.5	1.6	10.2
International Affairs ^a	21.5	18.7	21.3	20.4	-0.3	1.7
General Science, Space, and Technology	18.8	18.2	19.2	18.7	0.4	0.5
Energy	3.0	3.2	2.9	3.3	-0.1	0.1
Natural Resources and Environment	23.5	22.7	24.0	23.7	0.5	1.1
Agriculture	4.3	4.3	4.4	4.3	b	b
Commerce and Housing Credit	3.5	3.2	4.9	5.2	1.4	2.1
Transportation	14.4	42.0	14.7	45.6	0.2	3.6
Community and Regional Development	10.1	11.8	11.6	11.3	1.5	-0.5
Education, Training, Employment, and Social Services	46.6	46.0	52.1	49.8	5.6	3.8
Health	30.1	26.8	30.9	28.9	0.8	2.2
Medicare	3.0	2.8	2.9	2.9	-0.1	0.1
Income Security	33.1	40.6	32.0	42.9	-1.0	2.3
Social Security	3.2	3.3	3.2	3.3	0.1	b
Veterans Benefits and Services	19.3	19.1	19.3	19.3	b	0.2
Administration of Justice	26.1	24.3	26.3	26.4	0.2	2.0
General Government	14.3	12.9	12.7	13.5	-1.6	0.7
Allowances for Emergencies and Other Needs	0	0	0	1.4	0	1.4
Undistributed Offsetting Receipts	0	0	-0.2	-0.2	-0.2	-0.2
Total	555.0	574.1	564.0	605.3	9.1	31.2
Memorandum:						
Emergency Funding ^c	15.8	5.7	3.6	6.1	-12.2	0.4
Total Excluding Emergency Funding	539.1	568.4	560.4	599.3	21.3	30.9

SOURCE: Congressional Budget Office.

- a. Excludes \$18 billion in budget authority appropriated in 1999 for the International Monetary Fund.
- b. Less than \$50 million.
- c. For 1999, the amounts shown reflect enacted appropriations designated as emergencies and their resulting outlays. For 2000, budget authority represents the amount proposed by the President for that year. Outlays in 2000 are those estimated to result from emergency appropriations that were enacted in 1999 as well as from additional emergency appropriations proposed for 1999 and 2000 in the President's budget.

als regarding Supplemental Security Income would add \$1 billion in 2000 through 2004, and changes in a variety of other programs would boost spending by an additional \$7 billion during that period.

Although mandatory spending as a whole rises in the President's budget, some programs would face reduced funding. For instance, proposals to alter the Medicare program would reduce spending by \$1 billion in 2000 and \$9 billion in 2000 through 2004. In

addition, offsetting receipts would rise by \$6 billion in 2000 through 2004 because proposed hikes in military and federal civilian employee pay and military retirement benefits would trigger increases in agency (employer-share) payments to the military and civil service retirement funds. That estimate reflects the funds' receipts; increased payments to the funds are reflected in estimates of discretionary appropriations for civilian and military personnel costs. A new harbor maintenance fee would increase offsetting receipts

Table 1-6.

CBO Estimate of the Effect on Outlays of the President's Spending Proposals Excluding the Social Security Framework (By fiscal year, in billions of dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-2004	2000-2009
Discretionary	1	33	17	22	23	21	14	6	3	10	9	116	159
Mandatory													
Child care	0	1	2	2	2	3	3	3	3	3	3	9	23
Medicaid	0	a	a	a	1	1	1	2	2	2	3	2	12
Medicare	0	-1	-2	-2	-2	-2	-2	-2	-2	-2	-3	-9	-19
Supplemental Security Income	0	a	a	a	a	a	1	1	1	1	2	1	7
Employer share of employee retirement	0	-1	-1	-1	-1	-1	-2	-2	-2	-2	-3	-6	-17
Customs user fees	0	0	0	0	0	-1	-1	-2	-2	-2	-2	-1	-10
Harbor maintenance fees	0	a	-1	-1	-1	-1	-1	-1	-1	-1	-1	-4	-9
Net interest	a	a	1	2	2	3	4	4	4	5	5	9	31
Other	a	a	2	2	2	1	1	1	1	a	8	10	28
Subtotal	-1	-1	a	2	4	3	3	4	4	4	5	8	28
Total	1	31	18	25	27	24	18	10	7	14	14	124	187

SOURCE: Congressional Budget Office.

a. Less than \$500 million.

by \$5 billion over the same period, but repealing the existing harbor maintenance tax would reduce revenues by \$3 billion.

Revenue Proposals

The President has proposed a number of changes in tax laws that together would produce a net increase in revenues of \$11 billion in 2000 and \$96 billion in 2000 through 2009 (see Table 1-7). The proposals that would raise taxes would add \$176 billion to revenues, with 40 percent of that amount coming from higher tobacco taxes. Other provisions that push up revenues include a change in the sale-source rules for multinational firms.

Other types of proposals would reduce revenues by \$80 billion in 2000 through 2009. Revenue-reducing provisions include proposals for a new tax credit

to assist taxpayers with long-term health care needs, an increase in the credit for child and dependent care, and elimination of the harbor maintenance tax. In addition, as part of the Social Security framework, the President's recommendation to establish Universal Savings Accounts would further reduce revenues (see Chapter 2 for details).

Provisions That Increase Revenues

The President has proposed an assortment of changes that would raise revenues. Excise taxes on tobacco, air travel, and petroleum would provide more than half of those revenues. Increases in corporate income taxes would account for much of the remainder.

Tobacco. The President's budget includes an additional \$7 billion per year from increases in the tobacco excise tax. Under current law, the tax on cigarettes will increase from 24 cents per pack to 34 cents in

Table 1-7.
CBO Estimate of the President's Revenue Proposals Excluding the Social Security Framework
(By fiscal year, in billions of dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-2004	2000-2009
Provisions That Increase Revenues													
Increase tobacco taxes	-0.1	8.4	7.4	7.0	6.8	6.8	6.8	6.7	6.7	6.7	6.6	36.4	69.9
Change sales-source rules for multi-national firms	a	0.9	1.8	1.9	2.0	2.1	2.2	2.4	2.5	2.7	2.8	8.8	21.4
Modify rules for capitalizing life insurance costs	0	0.3	1.0	0.9	0.8	0.8	0.9	1.4	1.3	1.1	1.0	3.7	9.5
Modify rules for corporate-owned life insurance	0	0.2	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.6	1.8	4.4
Convert Airport and Airway Trust Fund taxes to user fees	0	1.1	1.2	1.1	1.0	0.9	0.8	0.7	0.6	0.4	0.2	5.3	8.0
Reinstate Superfund excise taxes	a	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.8	0.8	3.6	7.3
Reinstate environmental tax on corporations	0	0.9	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.7	3.3	6.7
Eliminate non-business valuation discounts	0	0.2	0.5	0.5	0.5	0.6	0.6	0.7	0.7	0.8	0.8	2.4	5.9
Other	<u>0.1</u>	<u>2.9</u>	<u>4.0</u>	<u>4.0</u>	<u>3.9</u>	<u>4.1</u>	<u>5.6</u>	<u>3.7</u>	<u>4.4</u>	<u>5.0</u>	<u>5.4</u>	<u>18.9</u>	<u>43.1</u>
Subtotal	<u>a</u>	<u>15.7</u>	<u>17.5</u>	<u>17.1</u>	<u>16.8</u>	<u>17.0</u>	<u>18.7</u>	<u>17.5</u>	<u>18.2</u>	<u>18.6</u>	<u>18.9</u>	<u>84.2</u>	<u>176.2</u>
Provisions That Reduce Revenues													
Assist taxpayers with long-term care needs	0	-0.1	-1.1	-1.3	-1.4	-1.5	-1.6	-1.6	-1.6	-1.6	-1.6	-5.4	-13.4
Increase child and dependent care tax credit	0	-0.2	-1.2	-1.3	-1.3	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-5.4	-12.4
Provide tax credits for school bonds	0	-0.1	-0.4	-0.7	-0.9	-1.0	-1.1	-1.1	-1.1	-1.1	-1.1	-3.1	-8.4
Eliminate harbor maintenance tax	0	-0.4	-0.5	-0.5	-0.6	-0.6	-0.7	-0.7	-0.8	-0.8	-0.9	-2.6	-6.4
Extend Puerto Rico economic activity tax credit	a	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.8	-1.6	-1.9	-1.2	-0.7	-6.4
Increase low-income housing credit cap	0	a	-0.1	-0.2	-0.3	-0.5	-0.6	-0.8	-0.9	-1.0	-1.2	-1.1	-5.6
Provide tax credit for fuel-efficient vehicles	0	0	0	a	-0.1	-0.6	-1.2	-1.9	-1.5	-0.1	a	-0.8	-5.5
Other	<u>-0.4</u>	<u>-3.8</u>	<u>-3.5</u>	<u>-2.4</u>	<u>-2.1</u>	<u>-1.8</u>	<u>-1.8</u>	<u>-1.8</u>	<u>-1.8</u>	<u>-1.7</u>	<u>-1.6</u>	<u>-13.4</u>	<u>-22.2</u>
Subtotal	<u>-0.4</u>	<u>-4.7</u>	<u>-6.9</u>	<u>-6.5</u>	<u>-6.9</u>	<u>-7.5</u>	<u>-8.5</u>	<u>-10.1</u>	<u>-10.7</u>	<u>-9.6</u>	<u>-9.0</u>	<u>-32.5</u>	<u>-80.3</u>
Total	-0.4	11.0	10.6	10.6	10.0	9.5	10.2	7.4	7.4	9.1	10.0	51.7	95.8

SOURCES: Congressional Budget Office; Joint Committee on Taxation.

a. Less than \$50 million.

2000 and 39 cents in 2002. Under the Administration's proposal, the rate would increase to 94 cents per pack on October 1, 1999, with no further scheduled increases. Excise taxes on other tobacco products would also increase under the Administration's proposal.

Export Sales Source. The President's budget would repeal a tax benefit under which U.S. multinational corporations can report some of their income from exports as foreign income, even if those exports are manufactured in the United States and the income is not subject to foreign taxes. That treatment allows certain multinationals to increase their use of foreign tax credits, which decreases their federal tax payments. Repealing the provision would raise \$21.4 billion through 2009.

The Joint Committee on Taxation (JCT) projects that repealing the provision will generate more than three times as much additional revenue as the Administration projects, largely because of different assumptions about foreign effective tax rates, the amount of excess foreign tax credits available to corporations, and corporations' sophistication in the use of certain foreign tax arrangements (specifically, the carryforward and carryback provisions).

Life Insurance. Two of the largest increases in revenues under the President's budget would involve life insurance. First, the budget would require life insurers to delay taking tax deductions for some of their costs of acquiring policies, such as commissions and administrative expenses. Before 1990, life insurers could immediately deduct (that is, "expense") the costs of policy acquisition activities, even though those activities generated income over multiple years. Legislation enacted in 1990 reduced the tax deferral by requiring life insurers to deduct over either five or 10 years a specified share of those costs, depending on the type of policy. The new proposal would increase that share and raise an estimated \$9.5 billion through 2009.

Second, the budget proposes to raise an additional \$4.4 billion through a change in firms' interest deductions. The Administration would bar a firm from deducting a proportion of its total interest deductions equal to the proportion of its total assets invested

in cash-value life insurance policies (except for policies on certain owners). A firm can increase its debt and invest the proceeds in life insurance on its employees and officers. The interest on such debt is immediately tax-deductible for the business, but the earnings on the policy are tax-deferred, which allows the business to use the deductions to shelter other business income. Although legislation enacted in 1996 and 1997 restricted the way firms could use such business-owned life insurance, the Administration argues that life insurance still provides firms with an opportunity for arbitrage.

Airport and Airway Trust Fund Taxes. The Administration proposes to convert the current excise tax into an unspecified system of user fees that would bring in an additional \$8 billion through 2009. Because no specific user fees were proposed, CBO used the Administration's estimates for that proposal.

Superfund. The President proposes to reinstate the taxes dedicated to the Hazardous Substance Superfund trust fund that expired in 1995. The excise tax on producers and importers of petroleum and certain chemicals would bring in \$7 billion through 2009. The additional corporate income tax that would be levied on all corporations would add another \$7 billion to revenues.

Estate and Gift Taxes. The proposal would limit the use of valuation discounts to active businesses. The valuation discount recognizes that a minority share of an active business is worth less than the proportionate share of its value to a sole owner. However, beneficiaries of estates in which control of the business is not an issue have been claiming the discount to reduce the value of other assets when they are divided at the time of the gift or death. This proposal would add \$6 billion to revenues through 2009. A number of other proposed changes to estate and gift taxes would generate more than \$2 billion in revenues.

Provisions That Reduce Revenues

The Administration has proposed several tax reductions that together would reduce revenues by \$80 billion in 2000 through 2009.

Health Care. The largest reduction in revenues would come from one of two initiatives to help taxpayers cover the costs associated with long-term care or disabilities. Under the proposal, taxpayers could claim a \$1,000 tax credit if they or their dependents were unable to perform at least three activities of daily living for at least six months or required substantial supervision to ensure health and safety. For the purposes of the credit, dependency tests would be liberalized, raising the gross income limit and using a residency test in place of a support test. The credit would be phased out for taxpayers with adjusted gross income above \$75,000 (\$110,000 for joint filers). JCT estimates that this proposal would reduce revenues by \$13.4 billion over 10 years; the refundable part of the credit would add \$1.5 billion to outlays.

The Administration also proposes a \$1,000 tax credit for workers with disabilities that leave them unable to perform at least one activity of daily living without substantial assistance for at least 12 months. That proposal would reduce revenues by \$1.5 billion over 10 years.

Credits for Child Care Expenses. The President's budget proposes to expand the personal tax credit related to expenses for child and dependent care. The credit is calculated as a percentage of qualifying expenses. Under current law, qualifying expenses are capped at \$2,400 for one dependent and \$4,800 for two or more; in general, they cannot exceed a taxpayer's earnings (or the earnings of the lower-earning spouse, in the case of a married couple). The President's proposal would not change those caps but would increase the maximum credit rate from 30 percent to 50 percent. As a result, the maximum credit would rise from \$720 to \$1,200 for families with one child and from \$1,440 to \$2,400 for families with two or more children.

In addition, the maximum rate would apply to taxpayers with income up to \$30,000, compared with up to \$10,000 under current law. The minimum credit rate would remain at 20 percent, but that rate would apply to taxpayers earning \$59,000 or more rather than \$28,000, as under current law. The President's proposal would also index all of the dollar amounts for inflation after 2000. The Administration further proposes to provide an additional credit for families with

children under age 1, whether or not they incur child care expenses. The new credit would equal the rate described above times \$500 (\$1,000 if the family has two or more children under the age of 1). Finally, the President's proposal would simplify eligibility for the credit by eliminating the current complicated household maintenance test. Together, the above changes would reduce revenues by about \$12.4 billion through 2009.

The budget also proposes a new credit for businesses that incur child care expenses for their employees. The new credit would cost \$1.4 billion through 2009.

Education Tax Provisions. The Administration would allow state and local governments to issue more than \$20 billion in special bonds over the next few years to finance certain public school construction and modernization projects. The federal government would, in effect, pay the interest on those bonds by providing income tax credits to the bondholders. They, in turn, would include the credit amount in their taxable income just as if it were taxable interest. By JCT's estimate, the proposal would reduce federal revenues by \$8.4 billion over 10 years. Six other education proposals would reduce revenues by \$2.5 billion over the same period.

Harbor Maintenance Tax. The current tax would be eliminated, reducing revenues by \$6.4 billion over the next 10 years. That loss, however, would be more than offset by a new user fee, which would be classified as an offsetting receipt on the outlay side of the budget.

Puerto Rico Economic Activity Tax Credit. The President proposes to extend the credit for three years beyond its currently scheduled expiration date of December 31, 2005, and to allow firms established since October 13, 1995, to claim it. The changes would reduce revenues by more than \$6 billion over the next 10 years.

The Per Capita Cap on the Low-Income Housing Credit. Under current law, states each year are allowed to allocate tax credits for low-income housing that extend for 10 years. The total first-year cost of a state's credits cannot exceed \$1.25 times the state's

population. This proposal would increase the cap to \$1.75 per resident in 2000 and later years, thereby reducing revenue by \$5.6 billion over 10 years. Because the cost of the credits allocated each year is spread over a 10-year period, the full cost of the proposal will not be reflected until 2009.

Credits for Energy-Efficient Purchases. The President proposes to provide or extend temporary tax credits for the purchase of energy-efficient and alternative-fuel equipment. Vehicles, homes, heating and air-conditioning units, and combined heat and power units that meet certain standards would be eligible for the credits. The entire set of credits would reduce revenues by \$7.3 billion through 2009, with about three-quarters of that amount coming from the credit for fuel-efficient vehicles. That provision has two elements. First, it would extend the credit for electric vehicles through 2006 and eliminate the currently planned phaseout of that credit. Second, fuel-efficient hybrid vehicles would be eligible for credits based on how their fuel efficiency compares with that of comparable vehicles in their class. (The credit is higher for relatively more fuel-efficient vehicles, reaching a maximum of \$4,000 for each vehicle that is at least three times as fuel efficient as other vehicles in its class.) The credits for fuel-efficient vehicles would be fully phased out by 2007.

Other Proposals. The President proposes to extend temporarily a number of tax provisions that have expired or will expire during 1999. Other proposals include provisions to encourage retirement savings, reduce tariffs, and simplify various taxes.

Estimating Differences Between CBO and the Administration

CBO estimates that total budget surpluses will grow less rapidly over the next five years under the President's policies (excluding proposals that are contingent on agreement on Social Security reform) than they would under CBO's baseline. However, because CBO's economic and technical assumptions produce higher projected baseline surpluses than the Adminis-

tration projects under current law, the total surpluses projected by CBO under the President's basic policies are \$52 billion higher in 2000 through 2004 than the Administration estimates (see Table 1-8). Only in 2000 does CBO estimate a lower surplus than the Administration does.

Baseline Differences

CBO estimates that surpluses under current policies will be \$125 billion higher over the 2000-2004 period than the Administration estimates. That difference represents less than 1.5 percent of the total outlays projected by CBO over that period. Estimated higher revenues and lower outlays are almost equally responsible for the cumulative upward reestimate. In 1999, however, lower outlays account for about two-thirds of the \$31 billion difference.

CBO's estimates for discretionary and mandatory spending in 1999 are lower than those of the Administration. CBO projects that discretionary outlays will be \$7 billion lower in 1999, with the difference about equally divided between defense and nondefense programs, and that mandatory spending will be \$16 billion below the Administration's estimate. About two-thirds of that difference stems from CBO's lower estimate of spending for Medicare, a program that has experienced no growth for more than a year. CBO and the Administration agree that the growth in spending for Medicare will pick up but disagree on the timing—the Administration's estimates assume a quicker increase. CBO also assumes that a variety of income security programs—including unemployment insurance, the earned income tax credit, the Food Stamp program, and Temporary Assistance for Needy Families—will spend about \$5 billion less in 1999 than the Administration estimates.

CBO expects revenues to be \$8 billion higher in 1999 than the Administration projects, largely because CBO expects taxable income to be slightly higher. The economic forecasts of CBO and the Administration are quite similar overall (see Chapter 5). But CBO's slightly higher projections of taxable income also explain most of the difference in baseline revenue projections for all years through 2004 except 2000, when CBO's technical assumptions offset the effects

of different economic assumptions and produce a downward reestimate of \$2 billion. Altogether, small differences in economic assumptions account for \$58 billion of CBO's higher revenue estimate for the 2000-2004 period, but the effect on the surplus is offset by increases in outlays that result from the higher growth in the consumer price index and the slightly higher interest rates that CBO projects.

The baselines of both CBO and the Administration assume that discretionary spending will comply with the statutory caps that constrain appropriations in 2000 through 2002. CBO's projected discretionary spending for 2000 is \$2 billion lower, however, because CBO does not include adjustments (primarily for emergency appropriations) that would be made under current law at the end of this year if the President's proposed appropriations were enacted. CBO's projected mandatory spending for 2000 is \$16 billion lower than the Administration's (see Table 1-8). Estimates of spending for Medicare again account for the bulk—\$9 billion—of the reestimate. Outlays for income security programs under CBO's assumptions are \$6 billion lower than the Administration estimates, but spending for Medicaid is \$2 billion higher.

In addition, CBO's baseline estimate of mandatory spending in 2000 is \$3 billion lower than the Administration's because the Administration assumes in its baseline projection that the pay-as-you-go balance for 2000 will be spent. (The Administration's baseline also assumes that pay-as-you-go balances for 2001 through 2003 will be spent.) Since legislation would be required to increase spending or reduce revenues to dispose of those balances, CBO did not assume those costs in its current-policy baseline.

The differences between CBO's and the Administration's estimates of baseline outlays continue to shrink after 2000 (CBO's estimate is only \$4 billion lower than the Administration's in 2004). However, the excess of CBO's revenue projections over the Administration's grows (to \$27 billion in 2004), and the difference in estimates of the surplus returns to \$31 billion in 2003 and 2004.

Differences in Estimates of Proposed Policies

Whereas the Administration estimates that proposed policy changes will have essentially no net effect on the surplus through 2004, CBO estimates that those changes will reduce cumulative surpluses for 2000 through 2004 by \$73 billion. That reduction is the result of CBO's estimate that the President's proposed increases in spending will be larger than the Administration expects (see Table 1-8). Revenues only partially offset that higher estimate of spending—the Joint Committee on Taxation and CBO estimate that the President's tax proposals will increase revenues \$6 billion more than the Administration estimates in 2000 through 2004.

CBO's largest reestimate of the President's policies occurs in 2000. About three-fourths, or \$16 billion, of the \$21 billion difference between CBO's and the Administration's estimates of outlays in 2000 is accounted for by CBO's higher estimate of the outlays that would result from enactment of the President's requests for discretionary appropriations. Of that \$16 billion, \$2 billion stems from the anticipated adjustments to the caps (such as the increase required under the Balanced Budget and Emergency Deficit Control Act if emergency funding requested by the President is appropriated) that the Administration included in its baseline. CBO, however, does not include that amount in its baseline because the adjustments depend on enactment of the President's requested appropriations; the \$2 billion is included in CBO's reestimate of the policies proposed by the President.

Of the remaining \$14 billion difference in estimates of discretionary outlays for 2000, \$10 billion is attributable to CBO's higher estimate of outlays for defense programs. In every year since 1994, CBO's estimates of outlays from defense appropriations have exceeded the Administration's but have proved to be lower than the outlays that actually resulted. The difference between CBO's and the Administration's estimates of defense outlays for 2000 is larger than in recent years (it was \$5.7 billion in 1998 and \$3.7 billion

Table 1-8.**CBO Reestimate of the President's Budgetary Policies Excluding the Social Security Framework
(By fiscal year, in billions of dollars)**

	1999	2000	2001	2002	2003	2004	2000-2004
Administration Estimate							
Surplus Under the President's Budgetary Policies	79	117	134	187	182	208	828
Sources of Differences							
Baseline							
Revenues	8	-2	6	17	24	27	72
Outlays							
Discretionary	-7	-2	-1	a	-1	-2	-5
Mandatory	<u>-16</u>	<u>-16</u>	<u>-15</u>	<u>-9</u>	<u>-5</u>	<u>-2</u>	<u>-48</u>
Subtotal	<u>-23</u>	<u>-18</u>	<u>-16</u>	<u>-9</u>	<u>-6</u>	<u>-4</u>	<u>-53</u>
Total	31	16	22	26	31	31	125
Estimate of Proposed Policies							
Revenues	a	a	2	2	1	1	6
Outlays							
Discretionary	1	16	4	9	7	6	42
Mandatory	<u>-1</u>	<u>5</u>	<u>5</u>	<u>7</u>	<u>11</u>	<u>10</u>	<u>37</u>
Subtotal	<u>1</u>	<u>21</u>	<u>9</u>	<u>15</u>	<u>18</u>	<u>16</u>	<u>79</u>
Total	-1	-21	-7	-14	-17	-15	-73
Total Differences							
Revenues	8	-2	8	18	26	28	77
Outlays							
Discretionary	-6	14	3	9	6	4	36
Mandatory	<u>-16</u>	<u>-11</u>	<u>-10</u>	<u>-2</u>	<u>5</u>	<u>8</u>	<u>-11</u>
Subtotal	<u>-22</u>	<u>3</u>	<u>-7</u>	<u>6</u>	<u>12</u>	<u>12</u>	<u>26</u>
Total	30	-5	15	12	14	16	52
CBO Reestimate							
Surplus Under the President's Budgetary Policies	109	113	149	198	196	224	880
Memorandum:							
Economic Differences							
Revenues	6	3	5	11	16	22	58
Outlays	<u>1</u>	<u>5</u>	<u>10</u>	<u>14</u>	<u>19</u>	<u>23</u>	<u>71</u>
Subtotal	<u>5</u>	<u>-2</u>	<u>-5</u>	<u>-3</u>	<u>-2</u>	<u>-1</u>	<u>-13</u>
Technical Differences	25	-3	20	15	16	17	65

SOURCES: Congressional Budget Office; Joint Committee on Taxation.

a. Less than \$500 million.

in 1999). Of the \$10 billion, about \$6 billion can be attributed to the differences in analytic judgments about spendout rates for new appropriations and assumptions about the timing of disbursements of unexpended balances that have generated differences in the past.

The remaining \$4 billion difference can be traced to the Administration's not including in the defense budget the outlays from 1999 contingent emergency appropriation funding that had not been released at the time the budget was presented to the Congress, and to different estimates of the effect of an assortment of proposed changes in Department of Defense practices. Those changes would deny interim or progress payments for contracts between \$1 million and \$2 million in value, reconfigure the accounting of spending for maintenance of real property, allow the Secretary of Defense to cancel up to \$1.7 billion of enacted budget authority, and request appropriations only for the first-year costs of certain construction projects.

Unlike the Administration, CBO estimates that these proposed changes would produce little or no reduction in outlays. For instance, the Administration requests that \$5.3 billion in funding for some construction projects be split into two parts: an appropriation of \$2.3 billion in 2000 for the first-year costs of the projects and \$3 billion in advance appropriations for 2001 to cover the remaining costs. However, the Administration applied the same spendout rate to the first-year funding that had previously been applied when the total funding was all provided in the first year. CBO assumes that the first-year funds will be spent much more quickly since they are sufficient to cover only the first-year costs of the projects, pushing CBO's estimate of outlays in 2000 up by \$0.4 billion compared with the Administration's.

CBO estimates that the President's nondefense discretionary outlays are \$4 billion higher than the Administration estimates. Two reestimates account for the bulk of that difference. The President's budget proposes that legislative language be included in the Commerce, State, and Justice appropriation bill for 2000 that would accelerate an auction of a portion of the electromagnetic spectrum that current law prohibits the Federal Communications Commission (FCC) from beginning before January 1, 2001. The Adminis-

tration estimates that this action will produce an offset to discretionary spending of \$2.6 billion in 2000 (and offsetting costs of \$1.3 billion in 2001 and in 2002). Under current laws and policies, changes in mandatory spending (including timing shifts) resulting from legislation included in an appropriation bill are counted as discretionary spending for purposes of compliance with the caps. CBO assumes, however, that the FCC is highly unlikely to be able to move quickly enough on the proposed auction to produce any effect on outlays in 2000. CBO therefore estimates that accelerating the auction would produce a \$1.6 billion increase in receipts in 2001 and a corresponding loss of receipts in 2002, when CBO assumes the auction will be completed under current law.

More than \$1 billion of CBO's higher estimate of nondefense discretionary outlays is attributable to estimates of spending for highways and mass transit. The difference partly reflects CBO's assessment of the effect on highway spending of the delay in enactment of the Transportation Equity Act for the 21st Century in 1998. Because the funding provided by that bill did not become available until the summer of 1998, outlays for highway programs were lower in 1998 than had been anticipated. CBO assumes that the spending that did not occur in 1998 will carry over to subsequent years and has therefore increased its estimate of prior-year outlays that will occur in 1999 and 2000.

CBO also estimates that from 2001 through 2004, discretionary outlays resulting from the President's proposals will exceed the Administration's estimates, although by smaller amounts than in 2000.

About three-fifths of CBO's total reestimate of mandatory spending for 2000 is attributable to the Administration's treatment of the pay-as-you-go balance. The Administration included the costs of spending increases or revenue reductions equal to the pay-as-you-go balance in its baseline, although legislation would be required to actually achieve those changes in revenues or spending. It then assumed \$3 billion in savings relative to its baseline for eliminating the balance. By contrast, CBO—following the baseline rules of the Deficit Control Act that provide that revenues and mandatory spending are to be projected at current-law amounts, with a few specific exceptions—did not include costs equal to the pay-as-you-go balance in its

baseline. Thus, CBO does not count any savings from the absence of legislative proposals to spend the balance.

The other significant reestimate of a mandatory policy in 2000 is for student loans. The Administration proposes a variety of changes in the student loan program, such as using a national database of new employees to track students with outstanding loans as well as increasing and accelerating recalls of guaranty agency reserves (see Box 1-2). The Administration estimates that those proposals will yield net savings of about \$2 billion in 2000 compared with CBO's estimate of about \$1 billion.

On the mandatory side, the largest reestimate over the 2001-2004 period is for the President's proposed tobacco recoupment policy. According to the Administration, "U.S. taxpayers paid a substantial portion of the Medicaid costs that were the basis for much of the State settlement with the tobacco companies, and Federal law requires that the Federal Government recoup its share." The budget proposes to "waive direct Federal recoupment, if States agree to use a portion of funds from the settlement to support shared national and State priorities." The Administration assumes that this policy would reduce costs for those unspecified programs by \$16 billion in 2001 through 2004. In contrast, CBO estimates that any reduction in spending for the unspecified programs that might occur under the President's proposal will be offset by the loss of those Medicaid funds that could have been recovered under current law (CBO's baseline assumes recoveries of less than \$1 billion a year in 2001 through 2009) and therefore attributes no savings to the proposal.

Grants to State and Local Governments

CBO estimates that the federal government will transfer about \$260 billion to state, local, and tribal governments through various grants programs in the current fiscal year. Although most budget functions include at least some spending for grants, that spending is highly concentrated in four functions: health; income security; education, training, employment, and

social services; and transportation. In the first three, federal grants primarily support payments to or services for individuals. Outlays for grants under those functions (about \$210 billion) account for over 80 percent of the total grant spending for this year. The Medicaid program alone accounts for about 40 percent of that total, with \$107 billion of estimated grant outlays in 1999. Another 12 percent (\$30 billion) primarily funds transportation infrastructure projects, particularly the construction of highways, mass transit systems, and airports.

If the President's budget was enacted as submitted, outlays for grants would total \$283 billion in 2000, by CBO's estimate. That spending would include \$117 billion for discretionary programs and \$166 billion for mandatory programs such as Medicaid. The President's budget proposes a modest increase in spending for grants, compared with current law, in both the discretionary and mandatory spending categories.

In the discretionary spending categories, budget authority for grants in 2000 would rise by \$3.2 billion, or 4 percent, from this year's level (see Table 1-9). (Changes in budget authority present a much clearer picture of the President's policy proposals for discretionary programs than do changes in outlays because annual changes in outlays tend to reflect past funding actions as well as current decisions.) The President proposes significant increases in grants for education, training, employment, and social services (almost \$5 billion) and for community and regional development (almost \$1 billion). Within each of those functions, large increases for some grant programs would exceed significant but smaller increases for other programs. Total budget authority for grants would decline by about \$1 billion in each of two functions—administration of justice and income security.

The largest proposed increase in the education, training, employment, and social services budget function is in state education grants for disadvantaged students. The President's proposal boosts the budget authority for such grants by over \$5 billion, to \$8.7 billion. That one-year jump would not, however, result in a large increase in spending for the program. Rather, it simply reflects a shift in the timing of appropriations. Should the President's request for next year be adopted, CBO estimates that outlays for the pro-

Box 1-2.
Student Loan Reserves

In recent years, the accumulated cash reserves of the guaranty agencies in the student loan programs have received considerable attention. Guaranty agencies operate as an intermediary between the federal government and student loan lenders, insuring the loans against default and making sure that students and schools meet program requirements. In addition, the agencies contact borrowers who have defaulted on their loans to establish repayment schedules and collections.

The cash reserves of the agencies have grown significantly because their income (primarily federal payments for administrative costs and reimbursements for defaulted loans, a share of the collections on defaulted loans, premiums on loans serviced by the agencies, and investment returns) has exceeded expenditures (mainly, insurance payments to lenders and the costs of servicing and collecting defaulted loans). The Higher Education Act of 1965 (HEA) was amended in 1997 and 1998 to recall substantial portions of the reserves—\$1 billion in 2002 as part of the Balanced Budget Act of 1997 and \$250 million over the 1999-2007 period as part of the Higher Education Amendments of 1998. The President's budget for fiscal year 2000 accelerates the later recall of \$250 million to 1999 and 2000 and seeks the recall of an additional \$1.6 billion over the next five years.

Scoring the recalled cash reserves as deficit reduction has produced some qualms. The 1992 reauthorization of the HEA sought to clarify ownership of the reserves, specifying that they were assets of the federal government. Although the logical outcome of that legislation would have been to include the existing reserves and the income and outgo of the guaranty agencies as part of the federal budget, there was no change in the manner in which the federal government recorded the agencies' finances. Subsequently, when the Congress and the Administration proposed to recall the cash reserves, the Office of Management and Budget (OMB) asserted that the recalls would be scored as offsetting receipts. The Congressional Bud-

get Office (CBO) reluctantly scored budgetary effects for the recalled reserves, but only if they were deposited in the U.S. Treasury and were no longer available to the guaranty agencies or the Department of Education.

The 1998 amendments required yet another change in how each guaranty agency's assets are recorded. They explicitly divide the reserves into a federal fund and an agency fund, with the latter fund deemed to be owned by the agencies. However, those separate accounts had not been established by the time the budget was released. Although the law clearly states that the federal fund is federal property, the budget continues to exclude all agency assets except those already scheduled to be recalled, displaying them as offsetting receipts. Thus, when the budget included additional recalls of amounts in the reserve funds, the scoring practice used in the past was followed again.

The portion of the current reserves that will be classified as federal and how those reserves are likely to grow over the next several years are uncertain. CBO's estimate for the reserve recall is significantly lower than the Administration's—\$500 million compared with \$1.6 billion—because CBO assumes that the available reserves are substantially smaller than those that would allow for a recall of the magnitude proposed by the Administration. The 1998 legislation incorporated many changes that will affect the level and distribution of federal and agency funds. In addition, the budget proposes other changes affecting the finances of the guaranty agencies—totaling \$1.9 billion over the next 10 years—that, combined with the loss of investment income associated with the proposed recall, led CBO to conclude that a recall of more than \$500 million would jeopardize the \$1 billion recall scheduled for 2002. When the audits of the agency reserves required for establishing the separate federal and agency funds are completed, CBO will reassess its assumptions about reserves available for recall.

gram would continue at a level close to that of recent years. The President proposes to reduce budget authority for other state education grants—those for special education programs—by \$1.7 billion. Again, however, that apparently large change does not reflect a large drop in spending. Other programs in this function that would receive significant increases in funding—a total of \$0.5 billion—include programs that provide services to children and families.

The growth in funding for the community and regional development function stems entirely from the President's request for a \$1.2 billion increase in budget authority for the disaster relief account. That account receives additional budget authority sporadically, often with the stipulation that it cannot be obligated unless it is released by the President as an emergency require-

ment. Except for that request, total discretionary budget authority for grant programs in the community and regional development function would decline by about \$0.3 billion, mostly as a result of cuts proposed in community development block grants.

Similarly, in functions that would receive reduced budget authority for grants under the President's proposals, the reductions can largely be explained as substantial cuts in a few programs. In the justice function, the targets of cuts include grants supporting state and local law enforcement and violent crime reduction programs, which would drop by \$1.3 billion. Specifically, the President proposes to eliminate local law enforcement block grants, juvenile incentive block grants, and grants for correctional facilities, and to sharply curtail grants to reimburse states for incarcer-

Table 1-9.
Estimate of the President's Discretionary Spending Proposals for Grant Programs, by Budget Function
(By fiscal year, in billions of dollars)

Function	1999 Budget Authority (Enacted)	2000 Budget Authority (Proposed)	Change from 1999 to 2000
Natural Resources and Environment	4.2	4.1	-0.1
Transportation	1.1	1.0	-0.1
Community and Regional Development	7.7	8.6	0.9
Education, Training, Employment, and Social Services			
Education for disadvantaged students	3.7	8.7	5.0
Special education	5.0	3.3	-1.7
Children and family services	5.7	6.3	0.6
Other	<u>13.8</u>	<u>14.9</u>	<u>1.1</u>
Subtotal	28.3	33.2	5.0
Health	5.4	5.6	0.2
Income Security	27.2	26.1	-1.1
Administration of Justice	4.9	3.6	-1.3
General Government	0.7	0.5	-0.2
Other	<u>1.2</u>	<u>1.2</u>	<u>a</u>
Total	80.7	83.9	3.2

SOURCE: Congressional Budget Office.

a. Less than \$50 million.

ating criminal aliens. In the income security function, the main contributor to the decline in budget authority is the housing certificate fund account. In that account, however, each year's spending comes largely from balances of budget authority provided in previous years. The proposed reduction in new authority for 2000 would thus have no effect on outlays in that year.

The President's policy proposals for entitlements and other mandatory programs would increase spend-

ing for grants next year by \$1.1 billion compared with current law. By far the largest increase would be for state child care grants, which would rise by over \$1 billion. Other proposals would lead to smaller increases in spending for trade adjustment assistance and grants aimed at securing jobs for welfare recipients. Spending for grants would be reduced only in the health care function as a result of the President's policy proposals. The President proposes few other significant changes in spending for mandatory grant programs.

The President's Framework for Social Security Reform

The budget includes a number of proposals as part of a package to reform Social Security and extend the life of the Medicare Hospital Insurance (HI) Trust Fund. Some of the proposals, such as an increase in discretionary spending, are not directly related to Social Security or Medicare but are described as contingent on agreement being reached on Social Security reform. The Congressional Budget Office (CBO) estimates that together those proposals will reduce the total budget surplus by \$1,076 billion in 2000 through 2009 (see Table 2-1). Some of the proposed changes would not affect the total budget surplus but would affect the on- and off-budget surpluses and balances held by the Social Security and HI trust funds.

The proposals in the President's framework for Social Security reform are to:

- o Make transfers from the general fund to the Social Security and HI trust funds.
- o Use \$280 billion of the money transferred to the Social Security trust funds to purchase corporate stock to be held by the trust funds.
- o Change the budgetary accounting rules so that certain amounts transferred to the Social Security trust funds would reduce the reported total budget surplus.
- o Provide seed money and matching funds totaling \$272 billion in 2000 through 2009 for Universal Savings Accounts (USA accounts).

- o Increase defense and nondefense discretionary spending above the levels assumed by the President's basic policies by \$318 billion in 2001 through 2009.

Together, those proposals would also add \$206 billion to net interest costs over the next 10 years.

CBO's reestimate of the President's proposals does not reflect the proposed change in budgetary accounting. Following long-standing practice and scorekeeping rules agreed to by the Congress and the Administration, CBO uses current budget concepts and rules to estimate the President's proposals and will adopt the proposed change only if it is enacted.

Because the Administration has provided little detail about the proposals in the Social Security framework, CBO's estimates are based on the costs of the programs included in the President's budget (except for CBO's own estimate of the resulting changes in interest costs). For instance, the budget does not specify which discretionary programs are to receive the proposed additional funding that is conditional on Social Security reform. Therefore, CBO cannot reestimate the effect of the funding on outlays.

Similarly, the Administration has provided almost no information about how the proposed USA accounts would work, and CBO has simply assumed a program that would cost the amount specified in the budget. For example, the budget does not indicate whether the costs of the USA program will be reflected as an increase in outlays or as a loss of rev-

Table 2-1.
**Estimate of the Effect on the Surplus of the President's Social Security Framework
(By fiscal year, in billions of dollars)**

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-2009
Surplus or Deficit (-) Under the President's Budgetary Policies Excluding Social Security Framework Proposals as Estimated by CBO												
On-budget	-17	-25	4	45	34	53	71	113	134	140	160	729
Off-budget	<u>127</u>	<u>138</u>	<u>145</u>	<u>153</u>	<u>162</u>	<u>171</u>	<u>184</u>	<u>194</u>	<u>204</u>	<u>213</u>	<u>218</u>	<u>1,782</u>
Total	109	113	149	198	196	224	255	307	338	353	379	2,512
Effect on the Surplus of the President's Social Security Framework Proposals^a												
On-budget												
General fund transfers to Social Security trust funds	0	-85	-70	-92	-90	-109	-121	-152	-177	-205	-232	-1,332
Additional discretionary spending	0	0	-26	-41	-36	-34	-38	-41	-39	-33	-30	-318
Universal Savings Accounts	0	-14	-16	-22	-21	-24	-26	-32	-36	-39	-43	-272
Interest paid to Social Security trust funds	0	-2	-5	-8	-12	-17	-22	-29	-37	-46	-57	-235
Net interest	<u>0</u>	<u>-1</u>	<u>-3</u>	<u>-6</u>	<u>-11</u>	<u>-15</u>	<u>-21</u>	<u>-26</u>	<u>-33</u>	<u>-41</u>	<u>-49</u>	<u>-206</u>
Subtotal	0	-101	-120	-169	-171	-199	-227	-279	-323	-364	-412	-2,363
Off-budget												
General fund transfers to Social Security trust funds	0	85	70	92	90	109	121	152	177	205	232	1,332
Purchase of stock by Social Security trust funds	0	-18	-15	-19	-19	-23	-25	-32	-37	-43	-49	-280
Interest paid to Social Security trust funds	<u>0</u>	<u>2</u>	<u>5</u>	<u>8</u>	<u>12</u>	<u>17</u>	<u>22</u>	<u>29</u>	<u>37</u>	<u>46</u>	<u>57</u>	<u>235</u>
Subtotal	0	68	60	81	84	103	117	149	177	208	241	1,287
Total Budget Effect	0	-32	-60	-88	-87	-96	-109	-131	-146	-156	-171	-1,076
Surplus or Deficit (-) Under the President's Budgetary Policies Including Social Security Framework Proposals as Estimated by CBO												
On-budget	-17	-126	-116	-124	-137	-146	-156	-166	-189	-223	-251	-1,634
Off-budget	<u>127</u>	<u>206</u>	<u>205</u>	<u>234</u>	<u>245</u>	<u>274</u>	<u>301</u>	<u>342</u>	<u>381</u>	<u>421</u>	<u>459</u>	<u>3,069</u>
Total	109	80	89	110	109	128	146	176	192	198	208	1,435

SOURCE: Congressional Budget Office.

NOTE: Because the budget did not provide a detailed description of the proposed Social Security framework proposals, CBO has used the Administration's estimates of all effects except the changes in interest payments.

a. Spending increases are shown with a negative sign because they reduce the surplus.

enues. At least some of the costs will almost certainly be counted as outlays even if the program operates through the tax code (for instance, refundable portions of tax credits are shown as outlays), but part of the costs may be shown as a loss of revenues. In the absence of details, CBO has assumed that the costs will be divided equally between outlays and revenues.

The budget also gives no details about how the transfers from the general fund to the Social Security trust funds would be calculated. Therefore, CBO has assumed that the transfers will equal the amounts included in the President's budget. The transfers themselves would have no effect on the total budget surplus (or debt held by the public) since they represent intragovernmental transfers. They would, however, affect the on- and off-budget surpluses. As shown in Table 2-1, the transfers (and the resulting increases in interest paid to the trust funds) and the costs of additional discretionary spending and USA accounts turn projected on-budget surpluses of \$729 billion in 2000 through 2009 into on-budget deficits of \$1,634 billion. The transfers of \$350 billion from the general fund to the HI trust fund in 2000 through 2009 affect the fund balances but not the total or on-budget surplus since they represent a transfer from the general fund to an on-budget trust fund.

In the budget, the President states that he will work to increase Social Security benefits for elderly widows and remove barriers to work that result from the Social Security earnings test. Those proposals are not included in the estimates in this chapter, however, because the Administration has not made any specific recommendations.

Elements of the Framework

The Administration's Social Security framework is designed to keep the total budget in surplus and to extend the solvency of the Social Security trust funds (Old-Age and Survivors Insurance and Disability Insurance) through transfers from the general fund and investments in corporate equities.

Proposed Budget Surpluses and Reduction of Debt Held by the Public

The main focus of the Administration's Social Security framework is to keep the total federal budget in surplus (under traditional accounting), although the surpluses would be less than those under current law and less than the projected Social Security surpluses. Excluding the Social Security framework, the President's budget would result in cumulative total budget surpluses of \$2.5 trillion over the 2000-2009 period (see Table 2-1). That is, the federal government would collect a total of \$2.5 trillion more from the public than it would spend in transactions with the public. That figure comprises off-budget (largely Social Security) surpluses of nearly \$1.8 trillion and on-budget surpluses of \$0.7 trillion.

The Administration's Social Security framework would reduce those budget surpluses by a total of \$1,076 billion over the next 10 years. Of that amount, \$280 billion would be used to purchase corporate stock for Social Security. The remaining \$796 billion would be devoted to discretionary spending (\$318 billion), USA accounts (\$272 billion), and additional debt-service costs (\$206 billion).

The President's policies, including the Social Security framework, would reduce federal debt held by the public from a projected \$3.6 trillion at the end of 1999 to \$2.3 trillion in 2009 (or \$1.9 trillion, if Social Security's holdings of equities are subtracted). Under CBO's baseline budget projections, however, debt held by the public would drop to \$1.2 trillion by 2009. Thus, debt held by the public under the Administration's policies (minus Social Security holdings of equities) would be more than \$700 billion higher in 2009 than if no new action was taken.

General Revenue Payments

The second major element of the Administration's framework consists of general revenue payments from the Treasury to the Social Security and Medicare Hospital Insurance trust funds. Over the 2000-2009

period, the Administration would credit an additional \$1,332 billion to Social Security and \$350 billion to Hospital Insurance—above and beyond the payroll taxes, interest, and other income that would be credited under current law. Social Security and Hospital Insurance currently receive hardly any general revenues; income taxes on benefits represent 2 percent and 3 percent of the programs' income, respectively. Medicare's Supplementary Medical Insurance Trust Fund, however, receives three-quarters of its income from general revenues.

Although the Administration describes the proposed general revenue payments as a use of the budget surplus, those payments would not alter the total surplus as traditionally measured. In fact, they would not affect the surplus no matter how large or small they were. General revenue payments are purely intragovernmental—a transaction between one government account and another. The general revenue payments to Social Security would move the government's on-budget accounts into deficit over the 2000-2009 period, but they and the payments to Medicare would not affect federal transactions with the public and would therefore have no effect on the economy.

The Administration's proposal further confuses the situation by treating the general revenue payments as a reduction in the total budget surplus, although not as a net outlay to the public. That approach can be viewed as an attempt to protect the surplus by making it seem to disappear, but it is not consistent with the principles of federal budgeting that were set forth by the President's Commission on Budget Concepts in 1967 and that have been followed for the past 30 years.

Some observers have worried that the proposed general revenue payments would substantially increase gross federal debt. That concern, however, is misplaced. The increase in the debt held by the Social Security trust funds would be merely a bookkeeping transaction and would not represent an increase in the net liabilities of the federal government. The government's liability for Social Security and Medicare is the obligation to pay benefits, and those benefits—and therefore the government's liability—would be unaffected by the proposed payments of general revenues and the balances in the trust funds.

Purchase of Equities

As a third element of its framework, the Administration proposes that one-fifth of the general revenues credited to Social Security, or \$280 billion over the 2000-2009 period, be used to purchase corporate equities or other private financial instruments. The dividends earned on the stock would also be reinvested in equities. CBO estimates that by 2009, Social Security's holdings of stocks would be valued at more than \$400 billion. In comparison, the total market value of stocks included in the Wilshire 5000 index—representing all companies headquartered in the United States whose equities are actively traded—was \$12.6 trillion at the end of 1998.

Like the proposed general revenue contributions, this element of the Administration's framework is designed to increase the balances in the Social Security trust funds. Under current law, those balances would total \$2.6 trillion at the end of 2009. Under the Administration's proposal, the balances would reach \$4.3 trillion (see Table 2-2). The Administration estimates that the proposals in its framework would keep Social Security solvent for the next 56 years. By themselves, the general revenue transfers would postpone the projected exhaustion of the Social Security trust funds from 2032 to 2049, under the intermediate assumptions of the Social Security trustees' 1998 report. The purchases of equities would extend that date until 2055.

Using a portion of the general revenue payments to purchase corporate stock would reduce the total and off-budget surpluses because CBO treats the costs of those purchases as an outlay (see Table 2-3). The appropriate treatment of federal purchases of common stock was not addressed by the President's Commission on Budget Concepts or in subsequent efforts to determine budget concepts and rules. However, in at least one case, the Administration, CBO, and the Congressional budget committees have treated a federal transaction in corporate stock as an outlay. Stock held by the District of Columbia's pension funds was taken over by the federal government under provisions of the Balanced Budget Act of 1997. Administration and Congressional estimates of those provisions showed that the assumed sale of stock by the federal government would produce offsetting receipts, implying that

Table 2-2.
Social Security Trust Fund Projections (By fiscal year, in billions of dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Baseline											
Income											
Payroll taxes	446	468	488	506	527	550	577	602	628	654	681
Income taxes on benefits	11	11	12	12	13	14	15	16	17	18	19
Federal employer contributions	7	8	8	9	10	10	11	12	13	14	15
Interest	52	58	64	71	79	87	96	105	115	126	137
Total	517	545	572	599	629	661	699	735	773	812	852
Outgo											
Benefit payments	384	400	419	439	460	483	508	534	562	592	627
Administrative expenses	4	4	4	4	4	4	4	4	4	4	5
Other ^a	4	4	5	4	4	4	4	4	4	4	4
Total	391	407	427	446	467	490	515	542	570	600	635
Surplus	127	137	145	153	162	171	184	193	204	212	218
Balance at End of Year	857	994	1,139	1,292	1,453	1,624	1,808	2,001	2,205	2,417	2,634
CBO Estimate of President's Budget											
Income											
Payroll taxes	446	468	488	506	527	550	577	602	628	654	681
Proposed general fund transfer	0	85	70	92	90	109	121	152	177	205	232
Income taxes on benefits	11	11	12	12	13	14	15	16	17	18	19
Federal employer contributions	7	8	8	9	10	10	11	12	12	13	14
Interest	52	59	69	79	91	104	118	134	152	172	195
Earnings on equities ^b	0	1	3	5	7	10	13	16	20	26	33
Total	517	632	649	703	738	796	854	931	1,007	1,089	1,175
Outgo											
Benefit payments	384	400	419	439	460	483	508	534	562	592	627
Administrative expenses	4	4	3	3	3	3	3	3	3	3	3
Purchase of equities	0	18	15	19	19	23	25	32	37	43	49
Reinvestment of earnings	0	1	3	5	7	10	13	16	20	26	33
Other ^a	4	4	5	4	4	4	4	4	4	4	4
Total	391	426	445	470	493	522	553	589	626	669	716
Surplus	127	206	204	233	245	274	301	342	381	421	459
Invested in Treasury securities	127	206	204	233	245	274	301	342	381	421	459
Invested in equities	0	19	17	24	26	32	38	48	58	69	82
Total	127	224	221	257	271	306	339	390	438	490	541
Balance at End of Year	857	1,062	1,267	1,500	1,745	2,019	2,320	2,662	3,043	3,463	3,922
Invested in Treasury securities	857	1,062	1,267	1,500	1,745	2,019	2,320	2,662	3,043	3,463	3,922
Invested in equities	0	19	36	60	85	118	156	204	261	331	413
Total	857	1,081	1,303	1,559	1,830	2,136	2,475	2,866	3,304	3,794	4,335

SOURCE: Congressional Budget Office.

a. Principally the annual transfer to Railroad Retirement and the quinquennial adjustment scheduled for 2001.

b. Consists of dividend income and realized and unrealized gains.

Table 2-3.**CBO Reestimate of the President's Budget Including the Social Security Framework (By fiscal year)**

	Actual 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009											
	In Billions of Dollars											
Revenues	1,722	1,814	1,874	1,933	2,014	2,090	2,182	2,285	2,384	2,489	2,600	2,715
On-budget	1,306	1,368	1,406	1,445	1,508	1,563	1,632	1,708	1,782	1,861	1,946	2,034
Off-budget	416	446	468	488	506	527	550	577	602	628	654	681
Outlays												
Discretionary spending	555	575	605	616	631	643	653	665	676	688	706	720
Mandatory spending	939	978	1,033	1,091	1,152	1,221	1,291	1,377	1,443	1,532	1,633	1,737
Purchase of equities	n.a.	n.a.	18	15	19	19	23	25	32	37	43	49
Offsetting receipts	-84	-78	-82	-89	-101	-97	-102	-109	-114	-121	-128	-136
Net interest	<u>243</u>	<u>229</u>	<u>219</u>	<u>211</u>	<u>203</u>	<u>196</u>	<u>189</u>	<u>180</u>	<u>171</u>	<u>161</u>	<u>150</u>	<u>138</u>
Total	1,653	1,705	1,794	1,844	1,904	1,981	2,054	2,139	2,208	2,297	2,403	2,507
On-budget	1,336	1,385	1,532	1,561	1,632	1,699	1,778	1,864	1,948	2,050	2,169	2,285
Off-budget	317	320	262	283	272	282	276	275	259	247	234	222
Deficit (-) or Surplus	69	109	80	89	110	109	128	146	176	192	198	208
On-budget	-30	-17	-126	-116	-124	-137	-146	-156	-166	-189	-223	-251
Off-budget	99	127	206	205	234	245	274	301	342	381	421	459
Debt Held by the Public	3,720	3,629	3,565	3,491	3,396	3,302	3,188	3,055	2,891	2,710	2,522	2,324
As a Percentage of GDP												
Revenues	15.5	15.6	15.5	15.3	15.2	15.1	15.1	15.1	15.0	15.0	15.0	15.0
On-budget	4.9	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.0
Outlays												
Discretionary spending	6.6	6.6	6.7	6.5	6.4	6.2	6.0	5.9	5.7	5.6	5.5	5.3
Mandatory spending	11.2	11.2	11.4	11.5	11.6	11.8	11.9	12.1	12.2	12.4	12.6	12.8
Purchase of equities	n.a.	n.a.	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.4
Offsetting receipts	-1.0	-0.9	-0.9	-0.9	-1.0	-0.9	-0.9	-1.0	-1.0	-1.0	-1.0	-1.0
Net interest	<u>2.9</u>	<u>2.6</u>	<u>2.4</u>	<u>2.2</u>	<u>2.1</u>	<u>1.9</u>	<u>1.7</u>	<u>1.6</u>	<u>1.4</u>	<u>1.3</u>	<u>1.2</u>	<u>1.0</u>
Total	19.7	19.5	19.7	19.5	19.2	19.1	19.0	18.9	18.6	18.5	18.6	18.5
On-budget	15.9	15.8	16.8	16.5	16.5	16.4	16.4	16.4	16.4	16.5	16.8	16.9
Off-budget	3.8	3.6	2.9	3.0	2.7	2.7	2.5	2.4	2.2	2.0	1.8	1.6
Deficit (-) or Surplus	0.8	1.2	0.9	0.9	1.1	1.0	1.2	1.3	1.5	1.6	1.5	1.5
On-budget	-0.4	-0.2	-1.4	-1.2	-1.3	-1.3	-1.3	-1.4	-1.4	-1.5	-1.7	-1.9
Off-budget	1.2	1.4	2.3	2.2	2.4	2.4	2.5	2.7	2.9	3.1	3.3	3.4
Debt Held by the Public	44.3	41.4	39.2	36.8	34.3	31.9	29.4	26.9	24.4	21.9	19.5	17.2
Memorandum:												
Gross Domestic Product (Billions of dollars)	8,404	8,762	9,095	9,476	9,904	10,358	10,837	11,337	11,855	12,391	12,946	13,521

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

the purchase of stock should be recorded as an outlay. That treatment, which is consistent with the basic assumption that budget transactions should be recorded on a cash basis, seems reasonable until the issues can be carefully considered and agreement reached on whether some other treatment would be more appropriate.

Although the anticipated increase in the value of the stock above the government's costs of borrowing to purchase the stock makes the Social Security trust funds look better, that comparison is incomplete because it ignores risk. By 2009, the annual dividends and capital gains on Social Security's portfolio of equities would total \$33 billion. The increase in the federal government's interest costs stemming from the purchase of stock, however, would be only \$15 billion. The difference between the earnings on stocks and the rate on government bonds is the so-called equity premium. For the purpose of this analysis, CBO adopted the Social Security actuaries' assumption that the equity premium will be about 4 percentage points. Actual equity premiums, however, could prove to be substantially lower or higher than that assumption. That uncertainty imposes risk on future taxpayers. The cost of bearing that risk is a factor to consider in judging the merits of Social Security investments in equities.

Other Elements of the Framework

In addition to the foregoing proposals, the Administration indicates that it will work with the Congress to develop additional proposals that will keep Social Security solvent for the next 75 years. In the context of those changes, the President has expressed his desire to eliminate the earnings test for Social Security retirement and to reduce the rate of poverty among elderly widows and other elderly groups. Because the Administration has not provided any details of those additional proposals, CBO cannot estimate how much they would cost. Depending on their scope and timing, however, their costs could be substantial.

For example, eliminating the earnings test for those who have reached normal retirement age (currently age 65) starting next January would cost about \$4 billion in 2000 and about \$16 billion over five

years. Eliminating the earnings test for younger people as well could double or triple the cost in the short run by inducing many workers ages 62 through 64 to file for benefits when they otherwise would have waited. The extra outlays from repealing the earnings test would decline over time, however, because workers who drew benefits earlier would incur permanent reductions in their monthly benefits. In the long run, repealing the earnings test would have little budgetary impact.

In calling for the reduction of poverty among the elderly, the Administration specifically noted the relatively high poverty rate among elderly women, particularly widows. Raising Social Security benefits across the board for widows by 10 percent would increase Social Security outlays by at least \$8 billion a year, with small offsetting savings in the Supplemental Security Income program. Targeting the increase toward the oldest widows or those with low Social Security benefits would lower those costs.

Issues Raised by the Framework

The effect of the Administration's framework on the short-run budget aggregates is only part of the picture, however, as is its effect on the status of the Social Security trust funds. For a more complete view of the proposal, it is necessary to step back and look at a broader range of issues.

Long-Term Fiscal Balance

The federal budget faces long-term pressures from demographic changes and rising health care costs, although the buoyant outlook over the near term will help delay the onset of serious fiscal problems for several decades. The large and rising surpluses projected for the next 10 years (under current laws and policies) will wipe out two-thirds of the federal debt held by the public, dramatically reduce the interest costs of servicing it, and thus provide a substantial cushion against future expenses. Over the following decades, however, the budget will face mounting pressures as the

baby-boom generation begins to draw benefits from Social Security and Medicare, the average life span increases, and the costs per beneficiary of federal health care programs continue to rise faster than average wages.

To analyze the magnitude of those pressures, CBO produces long-term projections of the federal budget. Under current laws and policies, the long-term projections indicate that debt held by the public will be eliminated by 2012. Soon after that, however, budget deficits will reappear, and by 2060 the debt will be as large as the gross domestic product (GDP). Those long-term projections depend on maintaining surpluses in the near term. If tax cuts or spending increases eliminated the surpluses projected for the next 10 years, the long-term outlook would be significantly worse. In that case, debt would be as large as GDP by 2033. Under the President's framework for Social Security, about 30 percent of the projected surpluses over the next decade would be used for tax cuts or spending increases (other than purchases of equities).

The long-term budget projections also show that programs for the elderly will absorb an increasing share of the federal budget. Today, the three largest federal transfer programs—Social Security, Medicare, and Medicaid—consume about 40 percent of federal receipts. By 2030, according to CBO's projections, they will consume about 70 percent of receipts and leave few budgetary resources available to address other national needs. The Administration's proposed framework for Social Security does nothing to alter that prospect.

Programmatic Issues

The Administration's framework for Social Security also raises several important questions about the structure of the Social Security program and the federal budget.

First, would breaking the link between payroll taxes and benefits eliminate an important mechanism of program discipline? In the past, the projected depletion of trust fund balances has often provided the impetus for taking painful steps to increase taxes or

scale back scheduled benefits. The imminent exhaustion of the Social Security trust funds spurred action in 1983, and shortfalls in the HI trust fund served a similar function in 1997. Although such deadlines may be artificial from an economic point of view, they can have real consequences. The President's framework essentially substitutes general fund solutions for programmatic solutions.

Second, would a massive infusion of nonpayroll taxes in Social Security significantly change the way the program is viewed? Heretofore, using payroll taxes has been considered integral to maintaining Social Security as a social insurance program. The program is financed by a nearly universal tax on earnings, and a person's benefits depend on the earnings on which taxes were paid. The use of general revenues could potentially undercut one or more elements of that carefully balanced system.

Third, is the purchase of equities by the federal government appropriate? Many analysts, most notably Federal Reserve Chairman Alan Greenspan, have questioned whether stock purchases for a defined benefit plan, such as Social Security, could be insulated from political influence and whether the federal government could refrain from attempting to affect the policies of the companies whose stock it owned. The Administration, pointing to the Thrift Savings Plan for federal employees, contends that it would be possible to develop a procedure to separate investment decisions from political considerations.

Finally, would accumulating balances in the Social Security trust funds be an effective way of encouraging more saving by the government? Put another way, would the proposed changes in accounting prevent the funds from being used for other purposes? Although the proposed general revenue transfers do not affect the total federal surplus (under traditional accounting), they increase the off-budget Social Security surplus and reduce the on-budget surplus. If the Social Security surpluses were viewed as sacrosanct, the transaction would reduce the amount of federal funds available for other purposes. Whether that approach would work for long, however, is open to question.

Chapter Three

Medicare Projections and the President's Medicare Proposals

Medicare is the second-largest federal entitlement program after Social Security. This year the program will pay for the health care of some 39 million elderly and disabled people at a cost of about \$216 billion, or 13 percent of federal outlays. The debate over the future of Medicare is occurring at a time when the growth in spending on Medicare has turned suddenly and unexpectedly flat. That trend, however, is not likely to continue.

The President's budget includes several initiatives to expand coverage and reduce spending in the Medicare program. Those proposals would have a small net effect on Medicare spending, reducing outlays by \$19 billion through 2009. The President would also transfer general revenues to the Hospital Insurance Trust Fund. That transfer would delay the date of insolvency of the HI trust fund but would not address the future budgetary pressures that will result from projected rapid growth in Medicare spending over the coming decades. This chapter first reviews trends in Medicare spending and then discusses the President's proposals.

Trends in Medicare Spending

The patterns of growth for Medicare and private-sector health spending diverged in the 1990s after both had grown at double-digit rates in the 1980s. A dramatic slowdown in the growth of private health spending in the mid-1990s was matched only recently by Medicare. Private health insurance spending increased

by less than 4 percent a year between 1993 and 1997, while Medicare spending continued to rise at an annual rate of almost 9 percent.

The growth of Medicare spending slowed sharply, however, in 1998. Total outlays, which had increased by more than 8 percent in 1997, rose by only 1.5 percent in 1998, and growth is expected to be extremely slow in 1999. Part of that slowdown was anticipated; the Balanced Budget Act of 1997 (BBA) lowered the projected growth of Medicare spending by an estimated 4 percentage points in 1998. The BBA reduced payment rates for many services and restrained the update factors for payments through 2002. Both fee-for-service providers and Medicare+Choice plans are experiencing lower increases in payments as a result.

But the actual rate of spending growth is considerably slower than the BBA provisions alone were expected to produce. Other factors appear to have contributed to the sudden flattening of Medicare expenditures, including greater compliance with Medicare payment rules and a longer time for processing claims.

Widely publicized efforts to clamp down on fraud and abuse in the program have resulted in greater compliance by providers with Medicare's payment rules. Those efforts include more rigorous screening of claims by Medicare contractors and tougher enforcement of Medicare laws by the Departments of Justice and Health and Human Services. Through investigations and lawsuits, those agencies have pursued a wide range of providers—including Columbia/HCA, teaching physicians, home health

agencies, clinical laboratories, and providers of durable medical equipment—as well as Medicare contractors themselves. Although the total reduction in spending growth attributable to the improved compliance cannot be quantified, the Congressional Budget Office estimates that one response alone to recent enforcement efforts—less aggressive billing by hospitals—lowered growth in Medicare spending by 0.75 percentage points in 1998.

The average time for processing Medicare claims rose dramatically in 1998. Expanded compliance activities, combined with major efforts to prepare computer systems for 2000, contributed to longer payment lags, which can have a substantial effect on Medicare

outlays. An increase of one week, for example, in the average time for processing claims reduces Medicare outlays for the fiscal year by 2.3 percent. But that reduction is only temporary because the delay merely moves outlays into the next fiscal year.

CBO expects that improved compliance with payment rules and longer claims-processing times will have little or no effect on the rate of growth of Medicare spending in the longer run. Mandatory Medicare outlays are therefore projected to grow at an average annual rate of about 7 percent through 2004, rising to slightly more than 8 percent over the 2004-2009 period (see Table 3-1). By 2009, total outlays are projected to be \$444 billion—more than double the

Table 3-1.
Medicare Outlays (By selected fiscal year)

	1990	1998	1999	2004	2009
In Billions of Dollars					
Gross Mandatory Outlays					
Benefits	107	210	212	298	443
Mandatory administration and grants ^a	<u>b</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>
Total	107	211	213	300	444
Premiums	-12	-21	-21	-34	-53
Mandatory Outlays Net of Premiums	96	190	192	266	391
Discretionary Outlays for Administration	<u>2</u>	<u>3</u>	<u>3</u>	<u>4</u>	<u>4</u>
All Medicare Outlays Net of Premiums	98	193	195	269	396
Average Annual Growth Rate from Previous Year Shown (Percent)					
Gross Mandatory Outlays	8.8	1.1	7.1	8.2	
Premiums	7.5	3.4	9.7	9.3	
Mandatory Outlays Net of Premiums	9.0	0.8	6.7	8.0	
Discretionary Outlays for Administration	1.5	7.4	4.7	4.0	
All Medicare Outlays Net of Premiums	8.8	0.9	6.7	8.0	

SOURCE: Congressional Budget Office.

a. Mandatory outlays for administration support peer review organizations, certain activities against fraud and abuse, and grants to states for premium assistance.

b. Less than \$500 million.

level in 1999. Much of the increase over the next few years reflects rising expenditures per enrollee; enrollment itself will expand only modestly as the last of the relatively small cohorts born in the late 1930s and early 1940s reach age 65.

Those baseline projections assume that payment lags will begin to return to more typical levels late in 2000, with a catch-up in spending and a resumption of normal spending growth in 2001 and 2002. That prediction is highly uncertain, however. Although the continuing attention focused on antifraud activities could slow the rate of spending growth for a considerable period, more typical Medicare expenditure patterns could resume sooner than CBO now predicts. If, for example, payment lags cause serious cash flow problems for providers, the Health Care Financing Administration (HCFA) might respond by instructing Medicare contractors to bypass claims-processing safeguards and accelerate payments.

Other administrative and judicial actions could also cause Medicare spending to rise in the near term. For instance, the settlement of current litigation or the acceptance (or loss on appeal) of a district court decision overturning Medicare's payment policies for outliers—inpatient stays with unusually high costs—could raise outlays by more than \$4 billion in 1999 or 2000.

Medicare spending will grow more rapidly in the decades after 2009 as the baby boomers begin to turn 65. Between 2010 and 2030, the elderly population will grow at a rate three times faster than between 2000 and 2010. Medicare costs are likely to grow considerably faster than program enrollment, however. The cost per beneficiary of providing health care services, which has risen dramatically in the past, is likely to continue doing so. That anticipated growth reflects advances in medical technology that are expected to raise health care costs and a continued increase in the use of services by beneficiaries.

Projections of Spending and Enrollment in Medicare+Choice

The Balanced Budget Act established the Medicare+Choice program to expand the range of health plans

from which beneficiaries could choose and to lay the foundation for a more competitive Medicare system. Building on the existing Medicare risk market, in which all of the plans were health maintenance organizations, the program allows a wide variety of health plans—including preferred provider organizations, point-of-service plans, and provider-sponsored organizations—to participate in Medicare. Medicare+Choice plans receive a fixed amount per enrollee, whereas traditional Medicare pays health care providers on a fee-for-service basis.

Payments for Medicare+Choice plans in CBO's baseline soar from \$37 billion in 1999 to \$141 billion in 2009 as enrollment in those plans continues to expand (see Table 3-2). The spending increase, however, also reflects growth in expenditures per enrollee that, under current law, will roughly mirror the performance of the fee-for-service sector. Despite that strongly positive trend, annual changes in Medicare+Choice spending will vary considerably. Those fluctuations reflect technical aspects of Medicare's reimbursement policy rather than sudden changes in underlying spending patterns.¹

For 1999, CBO projects that enrollment in Medicare's risk-based plans will grow by almost 12 percent, to 6.2 million. Although that increase is significant, it represents a sharp reduction from the previous estimate of 20 percent growth in 1999. The lower projection reflects the recent unanticipated withdrawal from the Medicare market of plans serving over 400,000 Medicare enrollees. A heightened awareness that plans can leave the market is likely to reduce the willingness of some Medicare beneficiaries to enroll in plans in the next few years.

CBO has also reduced the projected growth of enrollment in Medicare+Choice plans for 2000 and beyond because Medicare will phase in the risk adjustment of payment rates (to account for variations in

1. The volatility of projected annual rates of growth in Medicare+Choice spending is an artifact of Medicare's reimbursement policy and does not reflect underlying changes in the program. Medicare generally pays Medicare+Choice plans on the first day of the month. When the first day falls on a weekend or holiday, payments are accelerated to the last business day of the preceding month. In addition, the Balanced Budget Act alters some payment dates for group plans. For those reasons, the number of payments varies each fiscal year from 11 to 13; the growth of Medicare spending for group plans surges in years with 13 payments and slows in years with 11 payments.

Table 3-2.
Outlays for Medicare Benefits, by Sector (By fiscal year)

Sector	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
In Billions of Dollars												
Medicare+Choice ^a	32	37	41	49	48	60	70	88	88	108	124	141
Fee-for-Service												
Skilled nursing facilities	13	13	13	14	14	15	16	17	18	19	21	22
Home health	15	15	17	16	17	18	20	21	23	24	26	28
Hospice	2	2	2	2	3	3	3	3	3	3	4	4
Hospital inpatient ^b	87	86	91	95	99	104	108	112	117	123	129	135
Physicians' services	32	32	33	34	35	36	37	38	39	40	41	43
Outpatient facilities	17	16	17	18	20	21	23	25	26	28	30	33
Other professional and outpatient ancillary services	12	12	14	15	17	20	22	25	28	31	34	38
Subtotal	178	175	186	194	205	217	228	241	255	269	285	302
Total	210	212	228	243	253	277	298	328	343	378	409	443
Annual Growth Rate (Percent)												
Medicare+Choice ^a	26.3	14.0	11.7	18.0	-1.3	25.0	16.7	24.7	0.8	22.8	14.6	13.4
Fee-for-Service												
Skilled nursing facilities	8.9	-3.8	1.7	5.3	5.1	6.4	6.0	6.4	6.5	6.4	6.4	6.4
Home health	-14.9	0.8	10.3	-5.8	10.1	6.6	7.2	7.9	7.8	7.4	6.8	6.6
Hospice	1.0	2.5	8.6	6.3	4.6	5.7	5.3	5.7	5.8	5.7	5.8	5.8
Hospital inpatient ^b	-2.5	-1.5	5.7	4.7	4.5	4.7	3.9	4.1	4.5	4.6	4.9	4.8
Physicians' services	3.0	0.6	4.2	2.3	2.4	3.4	2.6	2.8	3.0	3.0	3.3	3.5
Outpatient facilities	-5.5	-6.6	8.4	8.5	7.1	7.7	7.2	7.4	7.3	7.3	7.6	7.9
Other professional and outpatient ancillary services	0.7	0.6	14.0	13.0	12.5	13.2	12.3	12.3	12.1	11.0	10.7	10.2
All Fee-for-Service	-2.1	-1.4	6.4	4.4	5.5	5.8	5.2	5.5	5.8	5.8	5.9	5.9
All Medicare Benefits	1.4	1.0	7.3	6.8	4.1	9.5	7.7	10.0	4.4	10.1	8.4	8.2
Memorandum:												
Part A Enrollment (Millions)												
Medicare+Choice	5.5	6.2	6.6	7.1	7.6	8.4	9.2	10.1	11.0	12.0	13.1	14.1
Fee-for-service	33.1	32.8	32.8	32.8	32.7	32.4	32.1	31.9	31.6	31.4	31.3	31.3
Total	38.6	39.0	39.4	39.8	40.3	40.8	41.4	42.0	42.7	43.5	44.4	45.4
Medicare+Choice share of enrollment (Percent)	14	16	17	18	19	21	22	24	26	28	29	31
Change in Enrollment (Percent)												
Medicare+Choice	23.4	11.8	7.0	7.1	7.4	10.5	10.2	9.6	9.0	8.8	8.6	7.8
Fee-for-service	-1.9	-0.8	-0.1	-0.1	-0.2	-0.8	-0.9	-0.9	-0.8	-0.6	-0.3	-0.2
Both Sectors	1.0	1.0	1.1	1.1	1.2	1.3	1.4	1.5	1.6	1.9	2.1	2.2
Part B Enrollment (Millions)	36.6	36.9	37.2	37.5	37.9	38.3	38.7	39.2	39.8	40.4	41.2	42.0
Number of Capitation Payments ^c	12	12	12	13	11	12	12	13	11	12	12	12

SOURCE: Congressional Budget Office.

- a. Includes spending for health maintenance organizations paid on a cost basis, certain demonstrations, and health care prepayment plans, which are paid on a cost basis for Part B services.
- b. Includes subsidies for medical education that are paid to hospitals that treat patients enrolled in Medicare+Choice plans.
- c. In general, capitation payments to group plans for the month of October are accelerated into the preceding fiscal year when October 1 falls on a weekend. In addition, the Balanced Budget Act of 1997 accelerates payments that would otherwise have been payable on October 1, 2001, to the last business day of September 2001. The October payments in 2000 and 2006 will be made on October 2 instead of September 29.

per-enrollee costs based on health status) in a manner that will reduce spending below previously projected levels for enrollees in Medicare+Choice plans. CBO had previously assumed that risk adjustment would be done on a spending-neutral basis (see Box 3-1). Reducing payment increases to Medicare+Choice plans will impede their ability to offer the additional benefits, such as prescription drugs, that were expected to encourage more people to enroll. On balance, CBO

projects that risk-based plans will account for 16 percent of Medicare enrollees in 1999, 22 percent in 2004, and 31 percent in 2009.

Because per-enrollee payments to Medicare+Choice plans are tied to fee-for-service expenditures, increased enrollment in those plans does not necessarily slow the rate of growth of Medicare spending. Although adjusting payments for risk will reduce the

Box 3-1.
Relationship of Fee-for-Service and Medicare+Choice Payments

Before enactment of the Balanced Budget Act (BBA), the Medicare program intended to achieve savings from managed care by paying risk-based plans 95 percent of the amount Medicare expected to pay if the plans' enrollees remained in the traditional fee-for-service sector. However, research suggested that Medicare beneficiaries who enrolled in risk-based plans tended to have lower costs than beneficiaries who did not switch plans. As a result of that "risk selection," Medicare payments to risk-based plans were generally estimated to be 5 percent to 8 percent higher, on average, than if enrollees in those plans had remained in the traditional Medicare program.

The Balanced Budget Act slowed the growth of fee-for-service spending, which also slows the growth of payments to Medicare+Choice plans because annual updates to Medicare+Choice payment rates are tied to the rate of growth in per-enrollee spending in the traditional Medicare program. Under the BBA, annual increases in Medicare+Choice payment rates are set below the growth in fee-for-service spending from 1998 through 2002. In addition, the portion of Medicare+Choice payment rates that is attributable to fee-for-service spending for graduate medical education will be gradually eliminated, and Medicare will withhold about 0.2 percent of the amount payable to Medicare+Choice plans to pay for dissemination of information to beneficiaries about their coverage options. Those policies will reduce the cumulative growth of Medicare+Choice payment rates relative to fee-for-service payments by 6 percent. The BBA also phased in the blending of local and national payment rates on a spending-neutral basis and required that the Health Care Financing Administration adjust Medicare+Choice payments to account for risk selection.

The Congressional Budget Office (CBO) previously assumed that adjustment of Medicare+Choice payments for risk would be implemented like the blending of local and national payment rates—on a redistributive but spending-neutral basis. That assumption seemed reasonable because the 6 percent reduction in Medicare+Choice payment rates relative to rates in the fee-for-service sector is about the amount of the expected overpayment attributed to risk selection.

The Administration recently announced plans to phase in risk adjustment in a manner that would reduce payment rates for enrollees in Medicare+Choice plans. The first stage of risk adjustment would be based on the use of inpatient hospital services by individual enrollees. That change would reduce payments by 7.6 percent when fully phased in, by 2004. The second stage would be based on utilization in all settings, and the Administration expects it would reduce payments by another 7.5 percent, beginning in 2004.

Payment reductions on the order of 15 percent would be likely to cause plans to drop out of the program and enrollment in Medicare+Choice plans to drop sharply. However, the Administration has considerable flexibility in the way it adjusts for risk, and it could choose not to reduce payments by that amount. Because the planned reduction far exceeds the estimated cost of risk selection, CBO, in developing its baseline projections, assumes that the Administration will revise those plans and implement risk adjustments in a manner that will ultimately reduce payments by lesser amounts.

spending growth by an average of 0.1 percentage point a year through 2004, CBO projects that per-enrollee payments to Medicare+Choice plans will grow in line with fee-for-service spending in subsequent years.

Projections of Spending and Enrollment in the Medicare Fee-for-Service Program

CBO projects that spending in Medicare's fee-for-service program will increase from \$175 billion in 1999 to \$302 billion in 2009. That growth will occur despite shrinkage in fee-for-service enrollment, which will decline by 1.5 million over the next decade, and cuts in the growth of payment rates for many services.

Spending growth for different services will vary considerably over the same period. The extent of the recent slowdown in spending has also varied by type of service, although spending for all services has been affected by the 1.9 percent drop in fee-for-service enrollment that occurred in 1998 and the further 0.8 percent decline expected in 1999.

Postacute Care Services. Growth in payments for skilled nursing facility (SNF) and home health services—the fastest-growing areas of fee-for-service spending in Medicare during the decade preceding passage of the Balanced Budget Act—slowed significantly in 1998. The most dramatic change was in spending for home health care, which actually fell by 14.9 percent in 1998. SNF expenditures, by contrast, continued to rise but at less than half the rate of growth in 1997—8.9 percent compared with 21.1 percent. The slowdown in spending reflects the implementation of new prospective payment systems, increases in the time for processing claims, and—in the case of home health services—recoupment of earlier overpayments. The rise in claims-processing times was particularly marked for home health services; a new sequential billing process added to the lags caused by factors affecting Medicare services more generally.

The transition to prospective payment systems is expected to hold the average annual rate of growth in spending through 2001 to 1.9 percent for skilled nursing services and 3.5 percent for home health care. Spending is then projected to increase through 2009 at

an average annual rate of 6.2 percent for SNF services and 7.5 percent for home health services.

Inpatient Hospital Services. Medicare payments for inpatient hospital services fell 2.5 percent in 1998, to \$87 billion. The factors contributing to that drop include a decline in the volume of services provided (reflecting the drop in fee-for-service enrollment) and several provisions in the BBA that froze payment rates for most operating costs, reduced capital-related payment rates by 17.8 percent, and cut subsidies for medical education. In addition, the case-mix index—a measure of the relative costliness of the cases treated in hospitals paid under the prospective payment system—fell 0.5 percent in 1998. Much of that unprecedented drop in the index is probably attributable to widespread adoption by hospitals of less aggressive billing practices following antifraud initiatives that focused on those practices.

For most hospitals, the Balanced Budget Act limits cumulative increases in payment rates for operating costs to about 6 percentage points below inflation over the 1999-2002 period. CBO projects that the limit on rate increases, in combination with declining fee-for-service enrollment, will result in a 1.5 percent drop in payments for hospital inpatient services in 1999. Those payments are projected to begin rising in 2000, with annual growth rates averaging 4.5 percent from 2000 through 2009.

Physicians' Services. Medicare payments for physicians' services rose 3.0 percent in 1998, to \$32 billion. Payments are projected to remain flat in 1999 and to grow at an average annual rate of 2.8 percent over the next decade, reaching \$43 billion in 2009. That growth rate is a result of payment formulas enacted in the BBA that tie the growth of per-enrollee expenditures for physicians' services to the growth of gross domestic product per capita. Those formulas generate annual rate changes that oscillate widely around a smooth trend. CBO projects stable growth rates, however, because the timing of those oscillations is impossible to predict.

Outpatient Services. Payments to outpatient facilities—such as hospital outpatient departments, dialysis facilities, and rural health clinics—fell by 5.5 percent in 1998 and are projected to decline another 6.6 percent in 1999. Those reductions result largely from

lower payment rates accompanying the transition to a prospective payment system for hospital outpatient services. Outpatient payments are projected to rebound in 2000 and grow at annual rates of 7 percent or more for the rest of the decade.

Spending for outpatient therapy services and other outpatient ancillary services—including pharmaceuticals, durable medical equipment, and chiropractic care—rose only 0.7 percent in 1998 as a result of reductions in payment rates and a cap on payments for therapy services performed outside hospitals. Projected payments for nonphysician professional services and outpatient ancillary services will grow only slightly in 1999 before taking off again in 2000. Annual spending growth is expected to average 11.3 percent from 1999 through 2009.

Proposals Affecting Medicare Spending in the President's Budget

The President's budget for 2000 includes provisions to expand Medicare coverage to new populations and to reduce the growth of spending in Medicare's fee-for-service sector. Populations newly eligible for Medicare would include certain people between the ages of 55 and 64, who would be allowed to buy in to the program, and the working disabled. The costs of those expansions would be more than offset by fee-for-service savings, which would have spillover effects on Medicare+Choice spending and also result in lower Part B (Supplementary Medical Insurance) premiums. The net effect would be savings in mandatory programs of about \$9 billion through 2004 and \$19 billion through 2009.

The budget also includes a \$750 million demonstration project to enable Medicare beneficiaries to participate in clinical trials. That program would be paid for through the general fund rather than the Medicare trust funds.

Policies to Expand Medicare Coverage

The President's proposals to allow people under age 65 to buy in to the Medicare program are similar to proposals that were in the budget last year. Two groups would be eligible to participate: people ages 62 to 64 who do not have private health insurance, Medicaid, or other public coverage; and certain workers ages 55 to 61 who lose their health insurance because of a job loss. The terms of participation would differ for the two groups.

A third proposal, to expand Medicare coverage for the disabled, is part of a broader initiative to allow the disabled to return to work and maintain their health insurance coverage. That initiative would use funding from both the Medicare and the Medicaid programs.

Buy-In for People Ages 62 to 64. The Administration proposes to allow people ages 62 to 64 who do not have employment-based health insurance, Medicaid, or other public coverage to enroll voluntarily in Medicare, provided they do so as soon as they are eligible. Events that would qualify people for enrollment include turning 62 or losing employment-based health insurance under certain circumstances between the ages of 62 and 64.

Medicare premiums under the buy-in would be paid in two parts, both of which would be updated annually:

- o Before the age of 65, enrollees would pay premiums that reflected the average expected cost of benefits if everyone ages 62 to 64 participated in the buy-in. The monthly premium would be about \$324 in 2001, the first year of the program. Premiums would be adjusted for geographic variation in Medicare's costs.
- o At age 65 and thereafter, buy-in participants would pay a premium surcharge (in addition to their regular Medicare premium) to recapture for the government the extra costs that Medicare would pay as a result of adverse selection in the

Table 3-3.
CBO Estimate of the President's Policies to Expand Medicare Coverage
(By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-2004	2000-2009
Buy-In Benefits												
Ages 62 to 64	0	1.5	2.4	2.7	3.1	3.5	4.0	4.4	4.8	5.4	9.7	31.7
Ages 55 to 61	0	a	0.1	0.2	0.2	0.3	0.3	0.4	0.4	0.5	0.5	2.5
Premiums												
Ages 62 to 64	0	-1.4	-2.1	-2.3	-2.7	-3.1	-3.5	-3.9	-4.3	-4.9	-8.5	-28.4
Ages 55 to 61	0	a	-0.1	-0.1	-0.2	-0.2	-0.3	-0.3	-0.4	-0.4	-0.4	-2.1
Net	0	a	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	1.2	3.7
Medicare for Working Disabled Benefits												
Premiums	a	a	0.1	0.1	0.1	0.2	0.2	0.3	0.3	0.4	0.3	1.7
Net	a	a	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.3	0.3	1.4

SOURCE: Congressional Budget Office.

a. Costs or savings of less than \$50 million.

buy-in program. The surcharge would reflect the difference between the premium paid before age 65 and the higher average costs of people who chose to participate in the program. CBO estimates that a person who enrolled in the buy-in program in 2001 at age 62 and who stayed in the program until age 65 would pay a surcharge of about \$23 a month in 2004.

CBO estimates that the Medicare buy-in for people ages 62 to 64 would raise outlays for Medicare benefits by \$31.7 billion between 2001 (when the program begins) and 2009 (see Table 3-3).² Premiums would total \$28.4 billion, resulting in net Medicare outlays of \$3.3 billion. About 473,000 people would participate in the program in 2001, rising to about 718,000 by 2009. In addition, Social Security benefits would increase by about \$0.2 billion a year under CBO's assumption that approximately 1 percent of

people ages 62 to 64 would retire if health insurance was available to them.

Buy-In for Displaced Workers Ages 55 to 61. The Administration proposes to allow certain workers ages 55 to 61 who lose health insurance because of a job loss to buy into the Medicare program. (Their spouses would also be eligible for coverage.) The program would be available only to people who met several eligibility requirements, including:

- o Having health insurance coverage for at least 12 months immediately before enrolling in the program;
- o Participating in their employer's plan immediately before losing their job;
- o Being eligible for unemployment insurance benefits; and
- o Being ineligible for any other employment-based or federal health insurance coverage. (That re-

2. The basis for the estimate is similar to the approach that CBO used in the estimate of the President's budget for 1999. See Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1999* (March 1998), pp. 37-42.

quirement means workers would first have to exhaust the 18 months of continued coverage from their former employer that is available under the Consolidated Omnibus Budget Reconciliation Act of 1985.)

Monthly premiums for the buy-in would be almost \$440 per person in 2001. They would be updated annually and adjusted for geographic differences in costs. Those premiums would not quite cover the costs of the program in the short term, however, because the program would attract enrollees who are expected to have high medical expenditures. Thus, CBO projects that net Medicare outlays would rise by about \$0.3 billion over the 2000-2009 period, reflecting outlays for benefits of \$2.5 billion and premiums of \$2.1 billion (see Table 3-3). The proposal would also encourage a small number of additional workers to seek unemployment insurance, raising federal outlays for unemployment compensation by an estimated \$60 million over 10 years.

Participation in the program would be low as a result of the stringent eligibility requirements and the relatively high premiums that enrollees would pay. By 2009, about 50,000 people would be enrolled in the program at any point in time.

Medicare Coverage for the Working Disabled. The President's budget includes provisions under both Medicare and Medicaid to enable disabled people to return to work and maintain their insurance coverage. The Medicare proposal would entitle disabled people who return to work—thereby losing their eligibility for Social Security benefits—to lifetime coverage under Medicare Part A (Hospital Insurance). That entitlement would be available only to people who enrolled during the first 10 years after enactment of the legislation.

CBO estimates that extending eligibility for Part A to the working disabled would increase net Medicare outlays by \$1.4 billion over the 2000-2009 period. By 2009, when enrollment in the program would end, 59,000 people would be participating in the program.

Comparison with the Administration's Estimates. The Administration estimates that the two buy-in pro-

posals for people ages 55 to 64 would raise net Medicare outlays by \$1.4 billion over the 2000-2004 period. That estimate is about the same as CBO's estimate of \$1.2 billion for the same period.

The Administration has combined its estimate of the Medicare expansion for the disabled with its estimate of the associated Medicaid provisions and has included additional costs for Social Security's Disability Insurance program. That combined estimate totals about \$0.9 billion over the 2000-2004 period, which is similar to CBO's estimate of \$1.2 billion.

Policies to Reduce Fee-for-Service Spending

The President proposes a variety of changes to reduce fee-for-service spending below projected levels, including:

- o Reductions in payments for certain services;
- o New requirements to improve compliance with Medicare's payment rules; and
- o Replacing a "centers of excellence" demonstration project with a permanent program to give hospitals and other providers incentives for greater efficiency and a higher quality of care.

Those proposals would reduce projected fee-for-service spending by about \$9.6 billion between 2000 and 2004 and \$21.2 billion between 2000 and 2009.³ Because the growth of spending in Medicare+Choice plans is linked to spending growth in the fee-for-service sector, the reductions in fee-for-service spending would also lower Medicare+Choice spending by \$2.1 billion through 2004 and \$6.5 billion through 2009 (see Table 3-4).

3. The President has also proposed a modification of the physician payment formula that would dampen the tendency of updates to physician payment rates to oscillate widely around a smooth trend, but would not affect the trend. CBO projects stable growth rates because the timing of those oscillations is impossible to predict. Therefore, CBO estimates that this provision would not have a significant effect on Medicare spending.

Table 3-4.
CBO Estimate of Medicare-Related Provisions in the President's Budget
(By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-2004	2000-2009
Gross Mandatory Medicare Outlays												
<i>Policies Affecting Benefits</i>												
Benefits for New Enrollees Under Buy-In and Working-Disabled Policies	a	1.5	2.6	3.0	3.4	4.0	4.5	5.0	5.5	6.2	10.6	35.8
<i>Policies Affecting Fee-for-Service Spending</i>												
Reductions in Payments												
Sustainable growth rate for physician payments	a	a	a	a	a	a	a	a	a	a	0	0
Freeze on PPS operating payment rates in 2000	-0.6	-0.7	-0.8	-0.8	-0.9	-0.9	-0.9	-1.0	-1.0	-1.1	-3.8	-8.7
Bad-debt payments	-0.4	-0.4	-0.4	-0.4	-0.4	-0.5	-0.5	-0.5	-0.5	-0.6	-2.0	-4.6
Outpatient pharmaceuticals	-0.3	-0.4	-0.4	-0.3	-0.2	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-1.8
Clinical laboratory payments	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-2.5
Prosthetics and orthotics	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.5	-1.2
Erythropoietin ^b	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5	-1.1
Requirements to Improve Compliance												
Secondary-payer reporting	0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.5	-1.3
Partial hospitalization	a	a	a	a	a	a	a	a	a	a	-0.1	-0.2
Civil monetary penalties	0	a	a	a	a	a	a	a	a	a	a	-0.1
Centers of Excellence	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.6
Long-Term Tax Credit	0.1	a	a	a	a	a	a	a	a	a	0.2	0.3
Interaction with Medicare+Choice Payment Rates ^c	<u>0</u>	<u>-0.5</u>	<u>-0.5</u>	<u>-0.5</u>	<u>-0.6</u>	<u>-0.7</u>	<u>-0.7</u>	<u>-0.9</u>	<u>-1.0</u>	<u>-1.2</u>	<u>-2.1</u>	<u>-6.5</u>
Subtotal	<u>-1.4</u>	<u>-0.9</u>	<u>0.1</u>	<u>0.4</u>	<u>0.8</u>	<u>1.2</u>	<u>1.7</u>	<u>1.9</u>	<u>2.1</u>	<u>2.5</u>	<u>-1.1</u>	<u>8.1</u>
Premiums												
Premiums for New Enrollees Under Buy-In and Working-Disabled Policies	a	-1.5	-2.2	-2.5	-2.9	-3.4	-3.9	-4.3	-4.8	-5.4	-9.0	-30.8
Part B Premiums for Beneficiaries Enrolled Under Current Law	<u>0.2</u>	<u>0.3</u>	<u>0.3</u>	<u>0.3</u>	<u>0.3</u>	<u>0.3</u>	<u>0.3</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>1.4</u>	<u>3.2</u>
Subtotal	<u>0.2</u>	<u>-1.2</u>	<u>-1.9</u>	<u>-2.2</u>	<u>-2.6</u>	<u>-3.1</u>	<u>-3.6</u>	<u>-4.0</u>	<u>-4.4</u>	<u>-5.0</u>	<u>-7.6</u>	<u>-27.6</u>
Net Mandatory Medicare Outlays												
Total	-1.3	-2.1	-1.7	-1.8	-1.8	-1.9	-1.9	-2.1	-2.3	-2.5	-8.7	-19.4

SOURCE: Congressional Budget Office.

NOTE: PPS = prospective payment system.

a. Costs or savings of less than \$50 million.

b. A drug used by patients receiving dialysis for end-stage renal disease.

c. The effect on payments to Medicare+Choice plans of changes in the rate of growth of fee-for-service spending.

One-quarter of the savings in Medicare Part B spending would accrue to beneficiaries in the form of lower premiums. Thus, beneficiaries would save \$1.4 billion through 2004 and \$3.2 billion through 2009.

Reductions in Payments. The largest savings from reducing payments to providers would come from the President's proposal to freeze payment rates for inpatient hospital services in 2000. In principle, those rates are updated each year to reflect changes in the costs of hospital inputs. The BBA specified, however, that the annual updates would be lower than the increase in input prices through 2002, with the update in 2000 being 1.8 percentage points less than the increase in input prices. CBO estimates that this reduction will give hospitals a 1.1 percent rate increase in 2000. Freezing the rates in 2000, as the President proposes, would save \$0.6 billion in 2000, \$3.8 billion through 2004, and \$8.7 billion through 2009.

In addition, the budget would further reduce Medicare's payments for the bad debts incurred by hospitals—those payments having already been lowered under the BBA—and extend the reduction in payments for bad debts to other providers. Those providers include SNFs, providers of outpatient physical therapy, comprehensive outpatient rehabilitation facilities, community mental health clinics, federally qualified health centers, and rural health clinics. Total savings from the reductions in bad-debt payments would be \$0.4 billion in 2000, \$2.0 billion through 2004, and \$4.6 billion through 2009.

Other services for which payments would be reduced include outpatient pharmaceuticals, tests performed by clinical laboratories, and prosthetic and orthotic devices. The Administration also proposes to reduce Medicare's payments for erythropoietin, a drug used by patients with end-stage renal disease and receiving dialysis. Savings from all of those payment reductions would be \$3.2 billion through 2004 and \$6.0 billion through 2009.

Requirements to Improve Compliance with Medicare's Payment Rules. The President's budget includes several initiatives to improve compliance with Medicare's payment rules and reduce fraud and abuse. In particular:

- o Group health plans would be required to notify Medicare of beneficiaries for whom they provide primary coverage. HCFA would then know immediately whether Medicare or a private insurer had primary responsibility to pay for a beneficiary's health services.
- o New rules would restrict the provision of partial hospitalization services for mentally ill patients. In addition, the Secretary of Health and Human Services (HHS) would be given more authority to screen out unqualified providers of that benefit and could impose civil monetary penalties on physicians who falsely certify that patients need those services.
- o The President proposes to reinstate the "reasonable diligence" standard for imposing civil monetary penalties on providers who submit false Medicare claims. That standard was changed under the Health Insurance Portability and Accountability Act of 1996, which raised the legal burden of proof for the federal government.

The provisions to improve compliance would save an estimated \$0.6 billion from 2000 through 2004 and \$1.6 billion through 2009.

Centers of Excellence. The Balanced Budget Act took important steps toward improving the efficiency of Medicare's fee-for-service program by establishing prospective payment systems for several services. The President's budget would seek further efficiencies by extending and making permanent a "centers of excellence" program enabling Medicare to contract with certain hospitals for the treatment of particular disorders. Those hospitals would be chosen on a competitive basis.

Under the proposal, the Secretary of HHS would be authorized to pay selected hospitals a single bundled rate for all services associated with an acute hospital admission. In 2001, contracts incorporating such global payments would be established with facilities for certain heart procedures and for knee and hip replacement surgery. Contracts for other procedures and medical conditions would be established in the future. The initiative would save a total of \$0.3 billion through 2004 and \$0.6 billion through 2009.

The President's Trust Fund Proposal

The President also proposes to augment Medicare's financing by transferring funds from the general fund to Medicare's Hospital Insurance (HI) Trust Fund. Medicare spending is drawn from two trust funds: the HI trust fund, which pays for Part A services, and the Supplementary Medical Insurance (SMI) Trust Fund, which pays for Part B services. Part A services include inpatient hospital care, home health services immediately following an inpatient stay, and SNF and hospice services. Part B services include physicians' services, other ambulatory services, and home health services for non-postacute care.⁴

Sources of Revenue for Medicare's Trust Funds

The HI trust fund relies primarily on payroll taxes, which account for 88 percent of its income. The remainder comes from taxation of Social Security benefits, premiums from beneficiaries who are not entitled to free enrollment in the Part A program, interest on fund balances, and other, smaller sources. By contrast, about 75 percent of SMI costs are financed by interest payments and transfers from the general fund, with premiums paid by beneficiaries accounting for the remaining 25 percent.

Taking both trust funds together, payroll taxes will account for 57 percent of Medicare's income in 1999, beneficiaries for 12 percent, interest payments

4. Before the BBA, most home health care spending came from the HI trust fund. Under the BBA, spending for non-postacute home health care is gradually being transferred to the SMI trust fund over a period of six years.

for 5 percent, and the general fund for the remaining 26 percent (see Table 3-5). The portion of benefits paid by SMI, however, will rise over the next decade as the transfer of spending for non-postacute home health care from Part A to Part B is phased in. Consequently, general fund financing will grow as a share of total revenues, reaching 37 percent of the total by 2009. Payroll taxes will account for only 45 percent of receipts in that year.

The shift of most home health spending to Part B will also enable the HI trust fund to maintain a positive balance over the next decade. But HI outlays will exceed receipts in 2007, and the trust fund balance will erode at an accelerating rate in subsequent years.

Effect of the President's Proposals on the HI Trust Fund

The President's proposed changes in Medicare benefits and eligibility would have an extremely small impact on the HI trust fund—a net increase of \$19 billion in 2009. The President also proposes, however, to address the solvency of the HI trust fund directly, by transferring \$350 billion from the general fund to the trust fund over the next decade. That transfer would increase the balance in the trust fund in 2009 by an additional \$435 billion (\$350 billion plus \$84 billion in additional interest payments) for a total of \$595 billion (see Table 3-6).

That bookkeeping transaction would delay the date of insolvency of the HI trust fund by several years. But the transfer would do nothing to address the underlying problem: rapid growth in spending for Medicare, Social Security, and other federal programs will cause total outlays to outstrip total anticipated revenues. If the growth in program spending is to be curbed, a major restructuring of Medicare will be required.

Table 3-5.
Medicare Outgo and Income in the CBO March 1999 Baseline (By fiscal year, in billions of dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Hospital Insurance											
Outgo											
Benefits	133	139	145	148	158	168	183	190	207	223	240
Mandatory administration	1	1	1	1	1	1	1	1	1	1	1
Discretionary administration	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>
Subtotal	135	141	147	151	161	171	186	193	210	226	243
Income											
Payroll taxes ^a	128	133	136	144	150	157	165	172	180	188	196
Payments by beneficiaries ^b	8	7	8	8	9	9	10	11	12	13	14
Interest on fund balances	9	10	10	11	11	12	12	12	12	12	11
General fund	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>
Subtotal	145	151	155	164	171	179	188	196	205	214	222
Surplus	10	10	8	13	10	8	2	3	-5	-13	-21
End-of-Year Fund Balance	127	137	145	158	168	176	178	181	176	163	142
Supplementary Medical Insurance											
Outgo											
Benefits	79	89	99	105	119	130	146	153	171	186	203
Mandatory administration	c	c	c	c	c	c	c	c	c	c	c
Discretionary administration	<u>1</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>
Subtotal	81	91	101	108	121	132	148	155	173	189	206
Income											
Payments by beneficiaries ^b	20	22	24	26	29	32	36	38	42	46	51
Interest on fund balances	2	2	2	3	3	3	3	4	4	5	5
General fund	<u>59</u>	<u>72</u>	<u>79</u>	<u>82</u>	<u>96</u>	<u>102</u>	<u>116</u>	<u>116</u>	<u>135</u>	<u>146</u>	<u>158</u>
Subtotal	81	96	105	111	127	138	155	159	181	196	214
Total											
Outgo											
Benefits	212	228	243	253	277	298	328	343	378	409	443
Mandatory administration	1	1	2	2	1	1	1	1	1	1	1
Discretionary administration	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>4</u>	<u>4</u>	<u>4</u>	<u>4</u>	<u>4</u>	<u>4</u>
Subtotal	216	232	248	258	282	303	333	348	383	415	449
Income											
Payroll taxes ^a	128	133	136	144	150	157	165	172	180	188	196
Payments by beneficiaries ^b	28	29	32	34	38	42	46	50	54	59	65
Interest on fund balances	11	12	13	14	14	15	16	16	16	16	16
General fund	<u>59</u>	<u>72</u>	<u>80</u>	<u>83</u>	<u>96</u>	<u>103</u>	<u>117</u>	<u>117</u>	<u>136</u>	<u>146</u>	<u>159</u>
Subtotal	226	247	260	275	299	317	343	355	386	410	436
Income as a Percentage of Total											
Payroll taxes ^a	57	54	52	52	50	50	48	49	47	46	45
Payments by beneficiaries ^b	12	12	12	12	13	13	13	14	14	14	15
Interest on fund balances	5	5	5	5	5	5	5	5	4	4	4
General fund	26	29	31	30	32	32	34	33	35	36	37
Memorandum:											
Monthly Part B Premium (Dollars)	45.50	49.50	53.90	58.00	64.10	70.70	76.80	80.90	88.20	94.60	101.20

SOURCE: Congressional Budget Office.

- a. Payroll taxes include the Federal Insurance Contributions Act (FICA) and Self Employment Contributions Act (SECA) payroll taxes, the equivalent to the FICA payroll tax for federal workers, and transfers from the Railroad Retirement account.
- b. Payments by beneficiaries include Part B premiums, Part A premiums paid for beneficiaries not entitled to free enrollment in the Part A program, and a portion of income taxes on Social Security benefits.
- c. Less than \$500 million.

Table 3-6.
CBO Reestimate of Medicare Outgo and Income in the President's Budget
(By fiscal year, in billions of dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Hospital Insurance											
Outgo											
Benefits	133	138	144	148	158	168	183	191	208	224	241
Mandatory administration	1	1	1	1	1	1	1	1	1	1	1
Discretionary administration	1	1	1	1	1	1	1	1	1	1	1
Subtotal	135	140	147	150	161	171	186	193	211	227	243
Income											
Payroll taxes ^a	128	133	136	144	150	157	165	172	180	188	196
Payments by beneficiaries ^b	8	7	8	9	10	11	12	13	14	15	17
Interest on fund balances	9	10	12	14	16	18	21	23	26	29	33
General fund	1	19	21	29	28	31	33	41	46	52	57
Subtotal	145	170	177	196	204	217	231	249	267	285	303
Surplus	10	29	31	45	43	46	45	56	56	58	59
End-of-Year Fund Balance	127	157	187	232	275	321	366	422	478	536	595
Supplementary Medical Insurance											
Outgo											
Benefits	79	88	98	105	119	131	146	154	172	188	205
Mandatory administration	c	c	c	c	c	c	c	c	c	c	c
Discretionary administration	1	2	2	2	2	2	2	2	2	2	2
Subtotal	81	90	100	107	121	132	148	156	173	189	206
Income											
Payments by beneficiaries ^b	20	22	24	27	30	34	37	40	44	48	53
Interest on fund balances	2	2	2	3	3	3	3	4	4	5	5
General fund	59	71	78	82	95	102	117	115	134	144	157
Subtotal	81	95	105	111	128	138	157	159	182	197	215
Total											
Outgo											
Benefits	212	226	242	253	277	299	330	345	380	412	445
Mandatory administration	1	1	2	2	1	1	1	1	1	1	1
Discretionary administration	3	3	3	3	3	3	3	3	3	3	3
Subtotal	216	230	247	258	282	304	334	349	384	416	450
Income											
Payroll taxes ^a	128	133	136	144	150	157	165	172	180	188	196
Payments by beneficiaries ^b	28	29	33	36	40	44	49	53	58	64	70
Interest on fund balances	11	12	14	16	19	22	24	27	31	34	38
General fund	59	90	99	110	122	133	150	156	180	196	214
Subtotal	226	264	282	307	331	355	388	409	449	482	518
Income as a Percentage of Total											
Payroll taxes ^a	57	50	48	47	45	44	42	42	40	39	38
Payments by beneficiaries ^b	12	11	12	12	12	13	13	13	13	13	13
Interest on fund balances	5	5	5	5	6	6	6	7	7	7	7
General fund	26	34	35	36	37	37	39	38	40	41	41
Memorandum:											
Monthly Part B Premium (Dollars)	45.50	49.10	53.30	57.40	63.50	70.10	76.30	80.30	87.60	93.90	100.50

SOURCE: Congressional Budget Office.

- a. Payroll taxes include the Federal Insurance Contributions Act (FICA) and Self Employment Contributions Act (SECA) payroll taxes, the equivalent to the FICA payroll tax for federal workers, and transfers from the Railroad Retirement account.
- b. Payments by beneficiaries include Part B premiums, Part A premiums paid for beneficiaries not entitled to free enrollment in the Part A program, and a portion of income taxes on Social Security benefits.
- c. Less than \$500 million.

Chapter Four

The President's Proposals for National Defense

The Administration is requesting about \$282 billion in discretionary budget authority for defense programs in fiscal year 2000. Most of that amount would go to the Department of Defense (DoD) for personnel compensation, procurement of weapon systems, research, construction of facilities, and day-to-day operating expenses of the armed forces. About \$13 billion of the total would support the nuclear weapons and environmental cleanup activities of the Department of Energy and the defense functions of other agencies. The Administration has proposed that a portion of the defense request after 2000 be contingent on enactment of legislation to reform Social Security.

The centerpiece of the defense budget is its attempt to improve recruiting and retention by granting a larger pay raise to all military personnel, increasing military retirement benefits for some personnel, and targeting other increases in pay and benefits for a third set of service members. An analysis by the Congressional Budget Office, discussed later in this chapter, finds that the retirement proposal would probably have little or no effect on recruiting and retention but would nevertheless be quite costly. The President's proposals for raising current compensation that are targeted toward specific problem areas offer more promise, but additional recruiters and increased advertising may be even more cost-effective recruiting strategies.

The Administration also proposes to increase appropriations for weapons procurement—a category of spending that has been held down since the end of the Cold War. Although the procurement budget

would rise from about \$49 billion in 1999 to about \$75 billion in 2005, it would remain below the level necessary to sustain today's forces. CBO estimates that over a period of decades, procurement budgets must average about \$90 billion (in today's prices) annually to replace equipment as it wears out or becomes obsolete.

The increases proposed for military compensation and weapons purchases would come at the expense of funding for day-to-day activities and research and development. Savings from base closings, outsourcing of activities, and other efficiencies are assumed to restrain costs in the operation and maintenance (O&M) spending category. Whether DoD can realize those savings is highly uncertain; in fact, compared with last year's request, the Administration's current budget would raise funding for that category. Savings in the research, development, test, and evaluation (RDT&E) areas may be easier to achieve because that program lacks a large, fixed spending component and thus annual funding is more subject to the discretion of policymakers.

Is the Defense Budget Proposal an Increase or a Decrease?

The Administration presents its request as a substantial increase in funding for defense—about \$112 billion more for DoD over the 2000-2005 period relative

to the request in the President's budget for 1999. But by another widely used measure (the CBO baseline), its request represents a decrease.

Compared with CBO's baseline projection of defense spending, which assumes that appropriations in 2000 and succeeding years will equal 1999 appropriations adjusted for inflation, the President's proposed budget authority represents a decrease of about \$8 billion in 2000 and about \$1 billion over the 2000-

2005 period. The CBO projection assumes that the \$8 billion in emergency appropriations enacted for 1999, which were not included in the President's 1999 budget request, will be repeated each year. If the higher spending from the emergency appropriations is excluded from the projected baseline in 2000 through 2005, the President's request represents an increase in every year. (See Box 4-1, which compares the President's request with the CBO baseline and a baseline that excludes emergency appropriations.)

Box 4-1.
Emergency Appropriations for Defense Programs for Fiscal Year 1999

As part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act for 1999, the Congress provided \$8.3 billion in emergency funding for defense programs. Although those funds were labeled emergencies, most were provided for ongoing programs and activities rather than for unforeseen circumstances.

- o The bill provided about \$1.9 billion for the Department of Defense's (DoD's) operations in such countries as Bosnia and Iraq; another \$1.5 billion was provided for intelligence-related activities.
- o General readiness appropriations totaled \$1.3 billion and included funding for military health programs.
- o The Congress also provided funds to help DoD guard against future threats from foreign countries as well as from terrorists—\$1.0 billion for research and development related to the nation's defense against ballistic missile attacks and an-

other \$0.5 billion for protection against terrorist attacks.

- o To help guard against potential Year 2000 and related computer failures, the Congress gave DoD an extra \$1.1 billion.
- o The Department of Energy received \$0.5 billion in additional funding for atomic energy activities.

In addition, the Congress provided \$0.5 billion to repair storm damage from hurricanes and other natural disasters.

For the most part, CBO's analysis uses the entire 1999 defense funding level, including the emergency appropriations detailed above, as a benchmark for comparison. The following table shows the differences in budget authority (by fiscal year, in billions of dollars) if emergencies are left out of the projection.

	2000	2001	2002	2003	2004	2005
CBO Baseline	289.5	297.4	305.3	313.4	321.2	329.7
Minus Emergency Appropriations	-8.6	-8.8	-9.1	-9.3	-9.6	-9.8
CBO Baseline Without Emergency Appropriations	280.9	288.5	296.3	304.0	311.7	319.9
Proposed Changes	0.8	12.8	6.8	9.4	10.5	13.7
President's Budgetary Proposals for 2000	281.7	301.3	303.1	313.4	322.2	333.5

The President's request also represents an increase relative to CBO's projections that assume appropriations in 2000 through 2005 will be frozen at the dollar level of 1999 appropriations without any adjustment for inflation. The increase is \$168 billion in budget authority over the 2000-2005 period compared with a freeze that includes projected emergency spending, and \$218 billion compared with a freeze that excludes emergencies.

The Administration's claim that its budgetary proposals increase defense spending is based on a comparison with its proposals of a year ago and takes into account the actual and projected rates of inflation in defense purchases. Over the 2000-2005 period, DoD's share of last year's budget for national defense totaled about \$85 billion less than its share in the current proposal. It also included about \$26 billion for growth in prices that actual experience in 1998 and the new price forecast would indicate is unnecessary. Nevertheless, the Administration still plans to use that funding for defense programs, which makes its current budgetary proposal for defense about \$112 billion higher than last year's after adjusting for the new economic forecast.

Some programs within the defense budget fare better than others in the Administration's new proposals. Nearly all categories of funding would increase compared with last year's request (see the top panel in Table 4-1). Increases in military compensation would add about \$34 billion over six years, and the O&M category would enjoy a comparable increase rather than being held relatively constant. A decline in weapons funding in 2000 would be more than offset by increases in later years. The program for research and development would be basically unchanged.

Measuring the budget request against the CBO baseline offers a different picture because it adjusts the 1999 funding level for inflation (see Table 4-1). Thus, under the Administration's proposals, military pay and allowances would increase above baseline levels as would programs to buy new weapons—by about \$3 billion and \$72 billion, respectively. All other major categories of defense spending would decline relative to baseline levels. Funding for day-to-day expenses covered under O&M accounts would fall by about \$22 billion over the 2000-2005 period, expenditures for research and development would fall by

\$37 billion, and all other defense spending would fall by about \$17 billion compared with the baseline.

Military Pay and Allowances

DoD attaches very high priority to attracting and retaining sufficient numbers of qualified military personnel. The Administration's budget request contains several initiatives to ameliorate recently reported problems, but some question remains as to whether it proposes the most cost-efficient methods for supplying the military departments with the kinds of personnel needed in today's armed forces.

Recruiting and Retention

DoD faces a challenge in recruiting and retaining the personnel it needs, but it is not clear that DoD is experiencing more than just a temporary difficulty. The reported problems vary from year to year, service to service, and sometimes within a service. In general, if problems with recruiting exist, they may involve attracting a sufficient number of recruits rather than recruits with the right qualifications. In terms of retaining personnel, the problems may be centered more on individual specialties and pay grades.

Recruiting. In addition to meeting numerical goals, DoD seeks to fill its ranks with qualified personnel. Its quality-related objectives call for at least 90 percent of recruits to be high school graduates and at least 60 percent to score above average on an enlistment examination. Every year since 1992, DoD has met or exceeded its objectives regarding the quality of its recruits, but 1998 was the first year during that period in which it failed to meet its numerical objective. In 1998, the Army fell short of its recruitment goal by 776 recruits (about 1 percent), and for the first four months of 1999, it is behind its goal by about 13 percent. The Navy suffered a 12 percent shortfall (about 6,892 recruits) in 1998 but has met its objectives so far in 1999. The Air Force and the Marine Corps fully achieved their objectives in 1998, and the Marine Corps is on track thus far in 1999. However, the Air Force currently is short of its 1999 objective by about 6 percent. For all services, DoD today is

Table 4-1.

**Major Funding Changes Proposed in the President's Budget for National Defense
Relative to the 1999 Budget Request and the CBO Baseline
(By fiscal year, in billions of dollars of discretionary budget authority)**

Category	2000	2001	2002	2003	2004	2005	2000-2005
Measured Against the 1999 Budget Request							
National Defense Budget as of February 1998	276.8	284.6	287.9	297.9	305.2	312.8	n.a.
Proposed Changes^a							
Department of Defense							
Military personnel	3.0	4.7	5.4	6.0	6.8	7.6	33.5
Operation and maintenance	7.5	5.8	5.2	5.7	6.5	7.2	37.9
Procurement	-1.1	0.5	1.6	3.0	4.3	8.7	17.1
RDT&E	0.5	1.3	1.1	0.2	-0.1	-1.7	1.3
Other DoD	-5.5	2.9	0.4	-0.4	-1.1	-1.4	-5.1
Subtotal	4.4	15.3	13.8	14.5	16.4	20.4	84.7
Atomic energy defense	0.4	1.4	1.2	0.9	0.6	0.3	4.7
Other national defense	0.1	0.1	0.2	0.1	0.1	0.1	0.7
Total	4.9	16.7	15.1	15.5	17.0	20.8	90.1
President's Budgetary Proposals for 2000	281.7	301.3	303.1	313.4	322.2	333.5	n.a.
Measured Against the CBO Baseline							
CBO Baseline ^c	289.5	297.4	305.3	313.4	321.2	329.7	n.a.
Proposed Changes^d							
Department of Defense							
Military personnel	b	0.3	0.1	0.3	0.9	1.5	3.0
Operation and maintenance	-0.1	-2.8	-4.8	-5.0	-4.7	-4.8	-22.2
Procurement	3.1	10.8	10.3	13.4	15.0	19.7	72.2
RDT&E	-4.1	-5.1	-5.6	-6.7	-7.1	-8.8	-37.3
Other DoD	-6.3	0.8	-1.8	-1.1	-1.9	-2.1	-12.5
Subtotal	-7.4	4.1	-1.8	0.9	2.1	5.4	3.3
Atomic energy defense	-0.4	-0.1	-0.4	-0.8	-1.1	-1.4	-4.3
Other national defense	b	b	b	-0.1	-0.1	-0.1	-0.2
Total	-7.8	4.0	-2.3	0.1	1.0	3.9	-1.2
President's Budgetary Proposals for 2000	281.7	301.3	303.1	313.4	322.2	333.5	n.a.

SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTES: DoD = Department of Defense; n.a. = not applicable; RDT&E = research, development, test, and evaluation.

a. DoD's current request minus last year's.

b. Less than \$50 million.

c. A projection of the 1999 funding level, including emergency appropriations, with full adjustment for inflation.

d. DoD's current request minus baseline.

meeting or exceeding its 1999 objectives for recruit education and aptitude levels.

Retention. The data on DoD's ability to retain military personnel after their first term of duty are less comprehensive than the data on recruiting and center more on individual military occupations than on broader categories. Moreover, post-Cold War reductions in forces make it difficult to draw conclusions about any current trend. According to DoD, all four branches of the military are facing challenges from private-sector firms seeking to recruit service members with directly marketable, and especially technical, skills.

- o For enlisted personnel, the Army and Marine Corps met their personnel retention goals for 1998 and are at least generally on track in 1999. The Navy and Air Force fell short of their goals in 1998 and continue to lag behind in 1999.
- o For officers, the Air Force may fall short of its goal in 1999 by 1,400 pilots, or 10 percent, although that goal includes pilots who do not fly aircraft as part of their current assignment. Pilot shortages may be less of a problem in the Navy and the Marine Corps. Retaining surface warfare officers is a major concern for the Navy, and the Army is worried about retaining officers in the grade of captain.

The Administration's Proposals for Military Compensation

The Administration's budget request for 2000 contains several proposals that would substantially increase military compensation, including modifications to military retirement, across-the-board pay raises, targeted pay raises, and extensions of and increases to certain bonuses and special pay. CBO estimates that those changes would increase discretionary defense spending by a total of \$14 billion through 2005 (compared with a baseline in which annual pay raises matched CBO's projection of the ECI, or employment cost index). Significant increases in retirement annuities (which are categorized as entitlement spending) would not occur until after 2006, when service members who began military service after July 31, 1986, reached 20 years of service.

Military Retirement. The Administration would modify the Military Retirement System for certain service members by raising the base level of benefits and increasing inflation protection.

Background. The Military Retirement Reform Act of 1986 (REDUX) governs the retirement of military personnel who initially entered the armed forces after July 31, 1986. The act lowered the base annuity for retirees with just 20 years of service; however, the longer people stay in the military, the less their base annuity is affected. (By 30 years of service, no difference exists between the base annuity under REDUX and the base annuity for military retirees under the prior system.) Cost-of-living adjustments (COLAs) under REDUX equal the change in the consumer price index (CPI) less 1 percentage point. (Retirees not covered by REDUX receive an adjustment equal to the full change.) When the retiree reaches age 62, the annuity is increased so there is no difference between a REDUX retiree and a retiree who entered military service after September 1980 but before August 1986. After reaching age 62, the only difference between REDUX and other retirees is that under REDUX, future COLAs continue to equal the CPI less 1 percentage point.

Proposed Changes. The Administration proposes to modify the REDUX retirement formula in two ways. First, it would overturn provisions that lowered the base annuity; in other words, service members covered by REDUX would receive the same multiple of their highest three years of base pay as people who entered military service between September 8, 1980, and July 31, 1986. Second, the Administration would alter the formula for COLAs under REDUX to allow a retiree to receive the same COLA as military retirees under the prior system when the CPI increases by less than 3 percent. CBO estimates that the Administration's proposals for modifying REDUX would cost about \$0.8 billion in 2000 and eventually total about \$2 billion a year. In the long run, the cost to DoD would be about 12 percent higher than under current law. (The unfunded liability would total about \$5 billion.)

Analysis of the Administration's Proposals. Most analyses of retention—both today and when REDUX was enacted—indicate that money spent on deferred compensation, such as retirement pay, has less impact on retention than money spent on the pay and benefits

that service members receive while still on active duty. CBO's recent analysis concluded that REDUX is not causing a large exodus of midcareer personnel.¹ That finding comes from comparing the retention decisions of thousands of service members who began active duty shortly after REDUX was implemented but who have been under different retirement systems because of their participation in different accession or commissioning programs. Using standard statistical methods, CBO isolated the effects of being under REDUX from the effects of other factors that might influence retention. The analysis controlled for such demographic variables as age, sex, marital status, and education as well as for occupation in the military and the possible effects of changes in the services' personnel policies during the force reductions that followed the Cold War.

CBO's analysis found that in general, being under REDUX had no discernible effect on the midcareer retention decisions of people who began active duty in 1987. The Navy was the only service in which REDUX had a statistically significant impact on retention of enlisted personnel between their 6th and 11th years of service. For enlisted members of the Army, Marine Corps, and Air Force, CBO found no statistically significant link between REDUX and retention during those years of service. The analysis of officer retention, which focused on the 8th through 10th years of service, identified a negative effect for the Air Force but not for the Navy. CBO was unable to examine data for Army officers, but an analysis by Dean Dudley, a professor of economics at West Point, concluded that REDUX did not have a statistically significant impact on their retention.

Those results are not surprising. In both cases in which a negative effect could be clearly identified, it was fairly small—a reduction of 3 or 4 percentage points in retention. Such relatively modest effects are generally consistent with what many analysts predicted when REDUX was enacted. Any large declines in midcareer retention that have been observed in the armed forces probably result from other factors, such as frequent, unscheduled deployments and attractive civilian job opportunities for people in particular occu-

pations. In CBO's equation for Air Force officers, for example, being a fighter pilot had a much larger negative effect on retention than being under REDUX. It is unlikely that repealing REDUX would compensate for those other factors. Yet despite REDUX's limited effects so far, the attention that the media and the military leadership have focused on it may result in a self-fulfilling prophecy that will hurt retention in the future.

Pay Raises, Bonuses, and Special Pay. DoD compensates military personnel with an assortment of basic pay, allowances for housing and subsistence, and bonuses and special pay for particular categories of personnel. Annual pay raises apply to basic pay and certain other items on an across-the-board basis, but other important elements of military pay are adjusted less frequently and may require legislation.

Proposed Changes. The Administration's budgetary proposals include an across-the-board pay raise in 2000 of 4.4 percent (0.1 percentage point above the employment cost index) and annual pay raises over the 2001-2005 period of 3.9 percent (equal to its projection of the ECI). In addition, the Administration proposes other measures directed toward certain groups of military personnel. One measure would target some mid- and senior-level personnel for pay raises of up to 5.5 percent.

In addition to basic pay and allowances for housing and subsistence, DoD also offers a variety of incentive and special payments to service members based on special skills or duty requirements. Incentive pay is given to those performing hazardous duty such as aviation service, submarine duty, and parachuting. Special pay is offered for certain types of skills or specific duty stations. The Administration's budget request for active-duty personnel in 2000 includes roughly \$660 million in incentive pay and about \$1.9 billion in special pay. Those amounts represent increases of 6 percent and 13 percent, respectively, over the levels in place for 1999.

Analysis of the Administration's Proposals. Although CBO has not analyzed overall trends in retention or tried to identify specific policies that would allow DoD to meet its personnel goals most efficiently, it has examined some of the policies contained in the Administration's budget request. In addition to the

1. Letter from Dan L. Crippen, Director, Congressional Budget Office, to the Honorable John W. Warner, Chairman, Senate Committee on Armed Services, March 2, 1999.

impact of the REDUX system, CBO has looked at the so-called pay gap between military and civilian personnel. CBO's analysis suggests that the current notion of a pay gap, in which military personnel across the board earn less than civilians, is not a useful guide to policy.²

If the current strength of the civilian job market continues in the near future, DoD may indeed be forced to devote considerably more resources than in the past to attracting and retaining a high-quality force. In the short run, it can be difficult to determine whether recruiting and retention rates are slipping or whether the changes that have been observed reflect normal year-to-year variations and the effects of a strong economy. If no clear trend is apparent, it may be appropriate to set a particular year's military pay raise equal to the growth in civilian earnings—as indicated by the ECI or by a similar measure tailored to reflect the demographic characteristics of military personnel. Matching civilian wage growth is reasonable in the short run because if nothing else changed (such as DoD's needs, the attractiveness of the military lifestyle to young people, or civilian unemployment rates), a policy that held relative wages constant might hold DoD's supply of manpower constant as well.

Over the long run, the best approach for determining military pay levels may be to ask whether recruiting and retention patterns allow the military to achieve its goals for experienced personnel. If DoD is consistently failing to attract and retain personnel across a wide range of occupations, then increases in military pay relative to civilian pay may be warranted. If retention or recruiting is a problem only for some services, some occupations, or, in the case of retention, for particular years of service, then other solutions—such as bonuses or changes in the pay tables—may be more cost-effective than across-the-board increases. In the case of recruiting problems, for example, additional recruiters, more advertising, or higher enlistment bonuses are more cost-effective solutions than across-the-board pay raises.

2. Statement of Christopher Jahn, Assistant Director, National Security Division, Congressional Budget Office, before the Subcommittee on Military Personnel of the House Committee on Armed Services, February 25, 1999.

A number of steps that the Administration is already taking are consistent with CBO's analysis of the issues related to military compensation. Under current law, DoD is adding resources in 1999 for recruiters, advertising, enlistment bonuses, and educational incentives. Similarly, the Administration's budgetary proposals for across-the-board pay raises, targeted pay raises, and increased bonuses and special pay address key parts of effective personnel policies.

Weapons Procurement

The long-term demographic pressures on the budget, and particularly on entitlement spending, are sizable and well documented. In some respects, defense weapons programs face similar pressures. DoD's inventory of weapons is aging, which is one reason the Administration is proposing to increase procurement funding from about \$49 billion in 1999 to \$53 billion in 2000 and \$75 billion in 2005. CBO estimates that sustaining DoD's current force structure in the long run would take an average of about \$90 billion a year (in 2000 dollars).

Over the 1990-1999 period, DoD's spending for procurement of new weapons fell by about 48 percent in real (inflation-adjusted) terms. The collapse of the Soviet Union and the consequent reduction in forces allowed DoD to maintain national security with the weapons it possessed or had on order and to postpone new purchases. For example:

- o In 1990, the Air Force had four major aircraft programs in production, the Navy had funding for four major aircraft, and the Army and the Navy were each purchasing two new types of helicopters. In 1999, procurement funding for major aircraft programs covers only a variant of the F/A-18 fighter, the V-22 tilt rotor aircraft, the C-17 transport, and F-22 fighters.
- o The Army's budget for 1999 contains no funding to purchase new, heavy combat vehicles, although by the end of the Cold War, it was buying over 1,000 a year.

- o In 1999, the Navy's shipbuilding account is funding roughly two-thirds fewer ships, although its requirements for ships have fallen by only about 50 percent.

Clearly, the current stock of weapons will wear out at some point. If forces remain at their current levels, replacing those weapons with others of the same or a more advanced design will take procurement budgets above the \$49 billion provided for 1999. In recent years, DoD has set \$60 billion as its notional target for new weapons purchases. But increases in funding to reach that level have been delayed by a year or two with each new budget submission. The delay means that DoD's inventory will be older and remain relatively old for longer than DoD may want. Nonetheless, procurement funding received a significant boost in 1999, and the Administration's budget proposals would continue that upswing in 2000.

The Administration's Procurement Budget

The Administration's budgetary proposals for 2000 would roughly maintain the funding levels for procurement set out a year ago in its 1999 request. After cropping the amount for 2000 by \$0.9 billion, the Administration projects increases in 2001 and later years. Yet compared with CBO's baseline, by 2005, procurement funding would increase by an inflation-adjusted 37 percent. Among the services, the Army would see a real gain of about 50 percent over 1999, with increases for the Navy and Marine Corps combined and for the Air Force of 38 percent and 26 percent, respectively.

Many more programs would see gains than losses—of the programs funded in 1999, six would receive less funding in 2005, but 30 others would receive more funding. In fact, by 2005, DoD plans to make funds available for several programs that received either no procurement funding in 1999 or relatively limited amounts. For example, the Army would receive funding for 14 Comanche helicopters in 2005 and 57 Crusader howitzer and resupply vehicles. The Air Force would buy 36 F-22 fighters in 2005 compared with the two aircraft it purchased in 1999.

The Administration's proposals also call for setting aside procurement funds in 2001 for national missile defense systems. The program's stated mission is the defense of all 50 states against a limited attack by a rogue nation; it would also provide some capability to defend the United States against a small accidental or unauthorized attack from more nuclear-capable states. Although the Administration plans to decide in June 2000 whether to deploy a national missile defense, its budgetary proposals include about \$4 billion for that purpose over the 2001-2005 period. (Combined funding for RDT&E and procurement of all theater and national missile defense programs would average about \$4.4 billion annually over the 2000-2005 period compared with \$4.0 billion appropriated for 1999.)

Despite DoD's proposed increases in procurement funding, over the 2000-2005 period some types of equipment either do not appear at all in the procurement plan, appear late in the period, or appear at low annual rates of procurement. As a result, the inventory of those weapons may become unusually old. For example, planes in the Air Force's tanker fleet, for which the service plans no replacement purchases at least through the next decade, have an average age of 39 years today; by 2007, their average age will be 47. The ages of Army tanks, Navy maritime patrol aircraft, and bombers would similarly increase. Purchases of some new systems—including light attack and scout helicopters by the Army, surface combatants by the Navy, and tactical fighter fleets by the Air Force and Navy—are too few or begin too late to halt aging completely during the next six years. Air Force and Navy fighter fleets are in the best shape: planned purchases of F-22s and F/A-18E/Fs will slow increases in the average age of those fighters.³

Yet in practice, DoD seldom has replacements in production for every weapon in its arsenal. As a result, it is not unusual for the average age of some systems to increase from year to year. At some point DoD buys a replacement system, which leads to reductions in average ages. An alternative view of weapons procurement focuses on average costs over a

3. Statement of Lane Pierrot, Senior Analyst, National Security Division, Congressional Budget Office, before the Subcommittee on Military Procurement of the House Committee on Armed Services, February 24, 1999.

span of time—often referred to as the steady state—that is long enough for replacement patterns to even out. The longer annual procurement is held below the steady-state level early in a period, the longer it may have to exceed that level in later years.

Procurement in the Steady State

CBO estimates that procurement budgets to sustain the current force would have to average about \$90 billion a year (in 2000 dollars) in the long run. That estimate is based on many assumptions and represents an order of magnitude for the level of procurement funding necessary to equip forces in the steady state. To the extent that DoD has broken away from its Cold War patterns of weapons procurement, the actual cost of maintaining procurement in the steady state may be less than \$90 billion. The military has accommodated itself to the lower funding levels of the past decade in part by using older equipment. It may continue to do so at a time when threats to security are relatively low and weapons research and development by potential adversaries may be much more limited than it once was.

Another reason the \$90 billion steady-state estimate may be too high is that it assumes that DoD would replace current weapons on a one-for-one basis. Yet DoD may be able to substitute cheaper or fewer systems for current equipment. For example, unmanned aerial vehicles may replace some piloted aircraft, and even when new aircraft enter the fleet, one new aircraft may replace more than one older one. Still, the greater capability in some next-generation weapon systems will probably come at a higher unit cost that may cause CBO's estimate to be too low.

Over the past several years, DoD delayed purchasing some new weapons because of lower overall funding and because savings in operation and maintenance accounts did not come as quickly as it had hoped. DoD places high priority on maintaining a force of about 1.4 million active-duty personnel and about 850,000 reservists, which precludes savings from the military pay accounts. Only two other parts of DoD's budget—the O&M and the RDT&E accounts—might be able to accommodate increases in weapons procurement funding through reductions in

their own allocations. The fixed costs and the lag in savings from efficiencies in the O&M accounts have meant that they did not decline by enough to free sufficient funding for new weapons. Thus, in its current budgetary proposals, the Administration relies more on the RDT&E than the O&M accounts to provide offsetting savings for its increase in procurement funds.

Other Defense Programs

The Administration would offset the cost of its initiatives in military compensation and weapons procurement by reducing funding (compared with the CBO baseline) for O&M and research programs. The O&M accounts fund a wide range of activities including the fuel used in weapons, utilities consumed in barracks and office buildings, health care for active-duty and retired beneficiaries and their dependents, and the pay of most civilian employees of DoD. RDT&E funding supports basic research in the sciences, development of technologies that may pertain to weapons in general, and application of those technologies to specific weapons programs. Despite increasing the O&M budget by almost \$40 billion above last year's budget request, over the 2000-2005 period, the Administration's current proposal for O&M funding would shrink that spending category by about \$22 billion, or 3 percent, below the inflation-adjusted level for 1999. Similarly, a slight increase in RDT&E funding compared with DoD's 1999 plan would nevertheless represent a decline, relative to the CBO baseline, of \$37 billion, or 15 percent, during the next six years.

Operation and Maintenance

Within the O&M accounts, readiness spending probably receives the highest priority, but the definition of readiness can be elusive and made so broad that it loses meaning. The Administration's budgetary proposals would maintain readiness as measured by the usual standards of flying hours, steaming days, and tank miles. Savings would come from base closures and efficiencies in other support activities.

Most of the savings that the Administration projects can be traced to changes in DoD's civilian workforce. By 2005, DoD expects to have about 87,000 fewer civilians on its payroll than in 1999, in large measure as a result of base closings and efforts to "outsource," or privatize, certain functions. CBO estimates that two additional rounds of base closings will ultimately save about \$3 billion annually. The O&M program also calls for increased use of competition between private entities and government (DoD) organizations in functions that could be performed by either. DoD expects ultimately to save about \$3.4 billion a year because either a lower-cost private source is found for a function that is being performed in-house or because the mere existence of competition forces the government source to become more efficient.

Additional Base Closings. Last year in a Congressionally mandated report, DoD estimated that it will have excess capacity of over 20 percent at its U.S. bases after closing all the facilities identified in the four previous rounds of closures. In its analysis, DoD compared the size of specific types of forces or workloads (measured, for example, by the number of aircraft or assigned personnel) with the size of the base structure that supports those forces or workloads (measured by the square feet of buildings or of apron space at airfields). DoD then estimated the amount of excess capacity by calculating the percentage reduction in the base structure that would result in the same ratios of forces to base structure that existed in 1989. (CBO believes that DoD's estimate of excess capacity is a reasonable estimate overall but may not be well suited for particular categories of installations.)

CBO estimates that if two additional rounds of base closings were undertaken and if they averaged about the same size as the last two rounds, the annual budgetary savings could amount to about \$3 billion in today's prices. However, before those savings could be realized, DoD would have to incur one-time costs, which could total about \$15 billion and prevent net savings before 2005. Actual budgetary effects would depend in large part on the specific bases that were closed. Savings from future rounds could be less than predicted if the excess bases that had not already been closed were those for which closure costs would be relatively high or recurring annual savings relatively low. Such a pattern could also extend the time re-

quired before the savings from the additional base closings would outweigh the costs. Yet even in that case, the ultimate savings from future rounds could still be significant.

Outsourcing. In November 1997, DoD issued a blueprint for reforming its business practices, its mix of public- and private-sector suppliers, and its organization. Outsourcing, one of the approaches in that blueprint, offers a clear chance of budgetary savings. But estimating the budgetary impact of outsourcing is more difficult than for many initiatives, including base closings. As a result, depending on significant savings from that approach entails a somewhat greater risk that they may not occur.

A recent report by the General Accounting Office (GAO) raises questions about the magnitude of eventual savings from outsourcing.⁴ GAO cautioned that DoD's initial savings—which the department has often estimated to be in the range of 20 percent to 30 percent of current costs—might eventually erode. For example, changes in work statements occurred in 18 of 53 competitions between public- and private-sector suppliers that GAO reviewed, and increasing labor costs in those and other cases diminished the initial savings that DoD projected. Another question involves projected savings from using nonmilitary workers. In some cases DoD might lower a requirement for military personnel in one function but then shift those individuals to other positions as part of a program to provide relief from overseas deployments.

Civilian Personnel. Most of the eventual savings from base closings and other support initiatives would stem from lower levels of civilian employment. The Administration's budgetary proposals call for civilian employment by DoD to fall from about 724,000 in 1999 to about 637,000 in 2005. Whether DoD will be able to reduce its civilian workforce that rapidly may depend on whether it can close bases quickly enough. (One of the two closure rounds being proposed will probably come too late to have a large effect on personnel by 2005.) Failing to achieve those reductions would wipe out some of the savings the Administration has used to offset the increases in funding sought

4. General Accounting Office, *DoD Competitive Sourcing: Results of Recent Competitions*, GAO/NSIAD-99-44 (February 1999).

for military compensation and weapons procurement. The risk of failure goes up the longer it takes to close bases and make other changes such as reductions in personnel employed in acquisition activities.

Research and Development

The Administration proposes to hold the funding level for RDT&E to about \$34 billion a year with little year-to-year variation over the 2000-2005 period. The current request is not much different from that of a year ago. But in 1999, appropriations for RDT&E totaled about \$36.6 billion; thus, the current request produces a real reduction in funding for that category that would total about 17 percent in 2005. Activities in the Army and Navy would fall by about 20 percent and 17 percent, respectively, in real terms. Air Force funding would fall below the CBO baseline by about 13 percent in 2005, and RDT&E in defensewide activities would be about 22 percent lower in that year.

DoD has long stressed the importance of a qualitative "edge" over potential adversaries, and funding for RDT&E has been a key part of maintaining that superiority. As in weapons procurement, a steady-state approach to RDT&E funding might appear to be useful. However, the aging of weapons would have less effect on the edge that U.S. forces now enjoy than would innovations developed by enemy forces. CBO has no specific information about such advances; moreover, the amount of spending necessary to maintain U.S. superiority against them is open to question. In 1990, budget authority for RDT&E totaled about \$44.3 billion in 2000 dollars. By 2005, the Administration's plan would take the category's budget authority to about 70 percent of that level, suggesting an order of magnitude for the increases that might be needed in the future.

Comparison of Economic Forecasts

The Administration's economic assumptions for the next six years are similar to those of the Congressional Budget Office. CBO's assumptions produce higher projections of both revenues and outlays than the Administration's assumptions do, but those projections largely offset one another. As a result, differences in economic assumptions account for little of the difference between CBO's and the Administration's projections of the budget surplus.

One important distinction is that the Administration's economic forecast—released by the Office of Management and Budget (OMB)—assumes that the policy proposals in the President's budget are implemented, whereas CBO's forecast assumes no new legislation. The Administration has made no specific claims, however, about how its policy proposals would affect the macroeconomic outlook.

Although CBO's and OMB's forecasts are fairly similar to each other, they show some important differences from the projections of other forecasters. The most recent *Blue Chip* consensus forecast, published in March, predicts stronger growth and lower inflation than either CBO or OMB for the next two years, as do the members of the Federal Reserve's Open Market Committee for this year. Specifically, the *Blue Chip* projects real growth averaging about half a percentage point higher and inflation half a percentage point lower than CBO does for 1999 and 2000.

Those other, more recent forecasts are more positive for 1999 in large part because economic data released in the four months since OMB and CBO made their forecasts indicate stronger growth and lower in-

fation in late 1998 and early 1999 than the two agencies assumed. For 2000, however, recent private-sector forecasts appear more positive than CBO's at least in part because CBO has incorporated the risks of a sharp slowdown in growth into its baseline forecast more fully than the *Blue Chip* consensus has.

Real Growth and Unemployment

Both OMB and CBO predict much slower growth in 1999 and 2000 than in recent years, as do most private-sector forecasters. In addition, the two agencies project virtually the same level of real gross domestic product in 2004. The Administration, however, foresees slightly stronger growth in the near term and correspondingly weaker growth in the medium term (see Table 5-1). The forecasts of unemployment rates are similar for the next three years, but CBO assumes a higher average rate in later years than the Administration does.

Recent data support forecasters who are predicting higher growth in the first half of 1999 than was generally assumed when CBO and OMB prepared their forecasts in early December. (That change is clear in the comparison of forecasts in Table 5-2, which, by showing growth rates from the fourth quarter of one year to the fourth quarter of the next, focuses more on developments during the year than the year-over-year comparisons in Table 5-1 do.) In the months immediately preceding the CBO and OMB

Table 5-1.
Comparison of Economic Projections for Calendar Years 1999-2004

	Forecast		Projected			
	1999	2000	2001	2002	2003	2004
Nominal GDP (Billions of dollars)						
CBO	8,846	9,182	9,581	10,015	10,476	10,960
Administration	8,833	9,199	9,582	10,004	10,456	10,930
<i>Blue Chip</i>	8,906	9,267	9,684	10,139	10,605	11,114
Nominal GDP (Percentage change)						
CBO	4.1	3.8	4.3	4.5	4.6	4.6
Administration	4.0	4.1	4.2	4.4	4.5	4.5
<i>Blue Chip</i>	4.5	4.0	4.5	4.7	4.6	4.8
Real GDP (Percentage change)						
CBO	2.3	1.7	2.2	2.4	2.4	2.4
Administration	2.4	2.0	2.0	2.2	2.4	2.4
<i>Blue Chip</i>	3.3	2.2	2.3	2.5	2.5	2.6
GDP Price Index^a (Percentage change)						
CBO	1.7	2.0	2.1	2.1	2.1	2.1
Administration	1.5	2.1	2.1	2.1	2.1	2.1
<i>Blue Chip</i>	1.3	1.8	2.2	2.2	2.1	2.2
Consumer Price Index^b (Percentage change)						
CBO	2.5	2.6	2.6	2.6	2.6	2.6
Administration	2.2	2.3	2.3	2.3	2.3	2.3
<i>Blue Chip</i>	1.9	2.3	2.5	2.5	2.5	2.5
Unemployment Rate (Percent)						
CBO	4.6	5.1	5.4	5.6	5.7	5.7
Administration	4.8	5.0	5.3	5.3	5.3	5.3
<i>Blue Chip</i>	4.4	4.6	5.0	5.1	5.1	5.1
Three-Month Treasury Bill Rate (Percent)						
CBO	4.5	4.5	4.5	4.5	4.5	4.5
Administration	4.2	4.3	4.3	4.4	4.4	4.4
<i>Blue Chip</i>	4.5	4.6	4.8	4.7	4.6	4.7
Ten-Year Treasury Note Rate (Percent)						
CBO	5.1	5.3	5.4	5.4	5.4	5.4
Administration	4.9	5.0	5.2	5.3	5.4	5.4
<i>Blue Chip</i>	5.0	5.2	5.4	5.5	5.4	5.5
Taxable Income^c (Billions of dollars)						
CBO	6,881	7,083	7,365	7,675	8,010	8,363
Administration	6,888	7,128	7,387	7,659	7,983	8,323

SOURCES: Congressional Budget Office; Office of Management and Budget; Aspen Publishers, *Blue Chip Economic Indicators* (March 10, 1999).

NOTE: Percentage changes are year over year.

- a. The GDP price index is virtually the same as the implicit GDP deflator.
- b. The consumer price index for all urban consumers.
- c. Taxable personal income plus corporate profits before tax. The *Blue Chip* does not project taxable income.

forecasts, concern about an economic slowdown was so widespread the Federal Reserve lowered interest rates by 75 basis points (0.75 percentage points). The economic data released since early December, however, indicate much stronger growth. The Commerce

Department now reports that the economy grew by more than 6 percent in the fourth quarter of 1998. Moreover, monthly data on retail sales, manufacturers' shipments and orders, residential construction, and foreign trade imply that growth in the first quarter

Table 5-2.
Comparison of Short-Term Economic Forecasts for Calendar Years 1999 and 2000

	Actual		Forecast	
	1997	1998	1999	2000
Percentage Change (Fourth quarter to fourth quarter)				
Nominal GDP	5.6	5.2	3.9	3.9
CBO			4.0	4.2
Administration			4.0-4.5	n.a.
Federal Reserve ^a			4.2	4.1
<i>Blue Chip</i>				
Real GDP	3.8	4.3	1.8	1.9
CBO			2.0	2.0
Administration			2.5-3.0	n.a.
Federal Reserve ^a			2.7	2.2
<i>Blue Chip</i>				
GDP Price Index ^b	1.7	0.9	2.1	2.0
CBO			1.9	2.1
Administration			n.a.	n.a.
Federal Reserve ^a			1.5	1.8
<i>Blue Chip</i>				
Consumer Price Index ^c	1.9	1.5	2.7	2.6
CBO			2.3	2.3
Administration			2.0-2.5	n.a.
Federal Reserve ^a			2.1	2.4
<i>Blue Chip</i>				
Average Level (Fourth quarter)				
Unemployment Rate	4.7	4.4	4.8	5.2
CBO			4.9	5.1
Administration			4.25-4.5	n.a.
Federal Reserve ^a			4.5	4.7
<i>Blue Chip</i>				

SOURCES: Congressional Budget Office; Office of Management and Budget; Federal Reserve Board; Aspen Publishers, *Blue Chip Economic Indicators* (March 10, 1999).

NOTE: n.a. = not available.

a. The range shown is the central tendency of forecasts by members of the Federal Open Market Committee.

b. The GDP price index is virtually the same as the implicit GDP deflator.

c. The consumer price index for all urban consumers.

of 1999 will be higher than the 2 percent generally expected just four months ago.

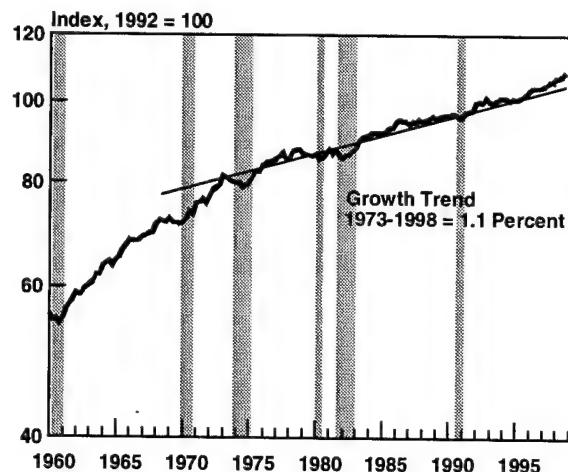
In spite of the recent data, most economic forecasters maintain that growth of GDP will slow dramatically during 1999 and 2000. Some economists, focusing on the supply side of the economy, argue that growth will be constrained by tight labor markets, which create the risk of higher inflation and monetary tightening; others, focusing on the demand side, stress the likelihood of an immediate slowdown in the growth of consumption, exports, and investment.

Possible Supply Constraints

Many economists expect that slower growth in the labor supply and in productivity will increase strains on the supply side of the economy. So far during the current expansion, growth in demand for goods and services has been balanced by growth in hours worked without putting undue strain on labor markets. Between the end of 1995 and the end of 1998, hours worked in the nonfarm business sector surged by 2.5 percent per year even though the population age 16 or older grew by only 1.1 percent. However, the labor market may be limited in its ability to respond that quickly to any further strong growth in the demand for goods and services. Although growth in hours might greatly exceed growth in the working-age population for two more years, the current low unemployment rate implies that many employers will have trouble finding qualified workers.

Like hours worked, productivity also surged during the past three years. In the nonfarm business sector, productivity grew by 2.4 percent in 1998 and by an average of 2.0 percent per year during the 1996-1998 period—well above the average growth rate since 1973 of 1.1 percent (see Figure 5-1). Rapid growth in investment in recent years has played a role in boosting productivity and will continue to do so during the projection period. But some of the recent jump in productivity probably stems from the rapid increase in output. Growth in labor productivity often increases when output increases because existing workers can be used more efficiently for a while when output growth accelerates. Some of the recent increase in productivity growth may prove transitory,

Figure 5-1.
Productivity



SOURCES: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics.

NOTE: The figure uses a logarithmic scale.

however. Growth in the output of goods and services may not be helped as much in the future by high rates of productivity growth, and that possibility, along with tight labor markets, may presage higher inflation. Interest rates would then rise, both because of market pressures and because the Federal Reserve would probably increase short-term interest rates as inflation rose in order to dampen future inflationary pressures.

Possible Slowdown in Demand

Other economists stress the possibility of a slowdown in the growth of demand by the second half of this year. A combination of falling exports, smaller gains in household wealth (which may slow the growth of consumption), and shrinking corporate earnings is expected by many forecasters to weaken demand growth dramatically.

After increasing by about 10 percent a year between 1995 and 1997, exports did not grow at all last year, and they are generally expected to shrink this year. Similarly, household wealth has grown much less rapidly during the past few quarters than it did between 1994 and mid-1998. Because gains in wealth contributed to the boom in consumer spending and

housing construction last year, the slowdown in gains suggests that consumption will receive less stimulus from that source in the future. Likewise, corporate economic profits shrank during 1998 after registering strong growth from 1995 through 1997. Pressure on corporate profits and internal cash flow is likely to restrict the growth of investment spending by businesses this year and next.

Possible Continuation of Strong, Noninflationary Growth

It is also possible that neither supply constraints nor the predicted slowdown in demand will materialize. Although exports have already weakened, consumption and investment have not slowed significantly. Growth in consumption declined from 6 percent in the first half of 1998 to 4 percent in the second half, but it appears likely to exceed 4 percent during the first quarter of this year. Business investment remained strong through the end of 1998, and initial indications imply only a moderate slowing in early 1999.

Economic growth of 3 percent next year with low inflation cannot be ruled out. Given the current expectations of low inflation (caused in part by falling import prices) and the possibility that growth in both the labor force and productivity will continue to be strong for another two years, the economy may outperform the *Blue Chip* consensus forecast. In fact, six of the 46 forecasters surveyed by the *Blue Chip* predict growth near 3 percent next year with little increase in inflation.

The Role of Different Types of Forecasts

Most private forecasters surveyed by the *Blue Chip* produce a "modal" forecast, which represents the most likely outcome in their view. Possible alternative outcomes, such as a recession, are not weighted into those forecasts. CBO, by contrast, produces an "average" forecast, which takes into account the probability of both worse outcomes and better outcomes.

Part of the reason that CBO's baseline forecast predicts slower growth in 2000 than the *Blue Chip* does may well be that difference between modal and average forecasts. Although CBO does not assign strict probabilities to various scenarios and publishes only a few alternative scenarios for illustrative purposes, its baseline forecast is intended to reflect economists' current perception that downside risks outweigh upside risks. In other words, compared with a modal forecast, the probability of strong growth in CBO's forecast appears to be smaller than the probability of weak growth. In the current environment, therefore, an average forecast for growth is smaller than a modal forecast.

Interest Rates and Inflation

The Administration's and CBO's forecasts of interest rates are quite similar to one another and to the most recent *Blue Chip* consensus. Forecasts of inflation, however, differ greatly for this year.

Forecasters are not predicting much movement in interest rates in the near term. The reason may be that the two broad scenarios that economists cite in forecasting slower economic growth imply opposite movements for interest rates. If the expected slowdown involves monetary tightening by the Federal Reserve because supply constraints risk higher inflation, short-term interest rates will rise. Conversely, if the factors that imply that demand will slow without monetary tightening turn out to be more dominant, interest rates will fall. The average of the rates for three-month Treasury bills through 2004 in the CBO, OMB, and *Blue Chip* forecasts is around 4.5 percent—which was also the rate recorded in February. The rates forecast for 10-year Treasury notes for this year and next year are also close to the actual rate in February: 5.0 percent.

With respect to inflation, CBO's forecast of the increase in the consumer price index (CPI) for this year now appears too high. That increase, 2.5 percent, is significantly higher than in the current *Blue Chip* forecast (although the CBO and *Blue Chip* forecasts for the CPI are similar for later years). Inflation during the past three months was lower than CBO's

forecast anticipated back in early December. Although an expected jump in the prices of tobacco products did occur, inflation for various other goods and services was surprisingly weak. The price declines in those categories may be partially reversed in coming months, but given the CPI data for December through February, CBO's forecast for CPI inflation for 1999 still appears too high.

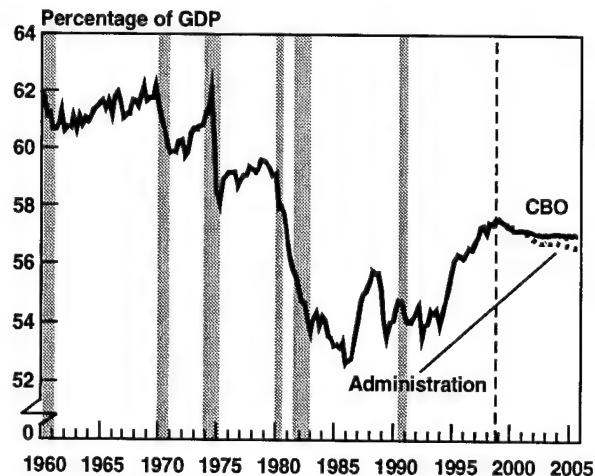
Income

Budget projections depend not only on the size of total output (gross domestic product) and the income generated in producing that output but also on the projected distribution of income among its various categories. Corporate profits and wages and salaries are the most important income categories for projecting revenues because they are effectively taxed at the highest rates. Other categories—such as dividends, interest income, proprietors' income, and rental income—are taxed at lower effective rates. Some of the income under those categories goes to tax-exempt entities (such as pension funds) or is imputed income, which does not show up on tax returns.¹ In addition, compliance problems reduce the effective tax rate on proprietors' income.

CBO's revenue projections are larger than the Administration's because CBO expects more wages and salaries and corporate before-tax profits over the next five years, on average. For fiscal year 2004, CBO's projection of those two income categories combined is about \$50 billion greater than the Administration's. The difference results partly because CBO's projection of overall GDP is higher (by \$27 billion) and partly because its projections of those categories as a share of GDP are higher.

As a percentage of GDP, wages and salaries plus corporate profits have grown rapidly since 1993 (see Figure 5-2). Both the Administration and CBO believe that the combined share has peaked, but the

Figure 5-2.
Wages and Salaries Plus Corporate Before-Tax Profits



SOURCES: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Office of Management and Budget.

Administration is projecting a slightly larger decline over the next six years than CBO is. That difference is a change from past forecasts: generally, the Administration has been somewhat more optimistic than CBO about income growth.

Three factors contribute to CBO's projected decline in the combined GDP share of wages and salaries and profits. First, CBO assumes that depreciation of plant and equipment will increase as a percentage of GDP. That assumption depresses the share of GDP accounted for by wages and salaries and profits because depreciation is deducted against profits before taxes. Depreciation, which is also called consumption of fixed capital (wear and tear and obsolescence of business equipment and structures), is expected to increase because the rapid growth in investment over the past five years, particularly in shorter-lived equipment, is likely to cause an increase in depreciation charges against profits.

Second, CBO assumes that overall income will grow less rapidly than overall output. In principle, total output should be identical to total income, but in practice those measures differ because they use different sources of data. Income growth has exceeded output growth for the past four years, leaving the measure

1. The national income and product accounts (NIPAs) impute income to households corresponding to their consumption of some services for which they are not specifically charged. For example, households consume services provided by financial institutions without specific charges, such as "free" checking, so the NIPAs include the value of those services as both income and consumption items for households.

of total income about \$100 billion greater than the measure of output at the end of 1997. CBO assumes that the difference between the two will shrink as a percentage of GDP, which implies that overall income grows more slowly than GDP in the projection.

Third, CBO's forecast includes the possibility of a recession over the next few years, which suggests a lower GDP share for wages and salaries and profits, on average, than in the recent past. CBO is not pre-

dicting that a recession will occur in a particular year. Instead, its projections assume that the likelihood of a recession occurring some time in the next six years is greater than the likelihood of the current boom continuing for the same period. Profits and wages and salaries as a share of GDP have generally been lower during a recession and the early years of a recovery than during the last half of an expansion. As a result, factoring in some probability of a recession lowers the average income share in CBO's projections.

Appendices

Appendix A

CBO Baseline Budget Projections

Throughout this report, the Administration's proposals are contrasted with the Congressional Budget Office's (CBO's) baseline estimates of the budget. Those estimates show the path of revenues and spending if current laws and policies remain unchanged. They are not forecasts of what will actually occur, since policymakers will undoubtedly seek to alter current priorities. But CBO's current-policy estimates serve as handy yardsticks for gauging the potential impact of proposed changes—those advocated in the President's budget as well as other initiatives.

The Baseline Concept

CBO's baseline projections follow some general rules. Revenues and entitlement programs (such as Social Security and Medicare) continue on their course until the Congress changes the laws that underpin them—laws that define taxable income and set tax rates, benefit formulas, eligibility, and the like. For those categories of the budget, therefore, the baseline represents CBO's best estimate of what will happen in accordance with current law. In the case of programs with outlays of more than \$50 million in the current year, the Balanced Budget and Emergency Deficit Control Act (the Deficit Control Act) directs CBO to assume that the programs continue even when their authorization expires (see Table A-1 for the budget authority and outlays associated with the continuation of expiring programs).

Discretionary programs, unlike entitlement programs, are funded anew each year through the appropriation process. Discretionary programs encompass nearly all spending for defense and international affairs, as well as many domestic programs—for example, space, energy, highway and airport grants, environmental protection, and health research—and the salaries and expenses of government agencies. Since 1991, dollar caps set by the Deficit Control Act have restricted spending for discretionary programs. The budget for 1999 has five categories of discretionary spending: defense, nondefense, violent crime reduction, highways, and mass transit. For fiscal year 2000, the Deficit Control Act combines defense and nondefense spending into an overall discretionary category but retains separate categories for violent crime reduction, highway, and mass transit spending. For fiscal years 2001 and 2002, the act groups violent crime reduction spending under the overall discretionary cap, leaving only three categories of spending. CBO's baseline assumes compliance with the caps through 2002. After the caps expire in 2002, the baseline assumes that discretionary spending grows at the rate of inflation.

The budget includes two other categories of spending: offsetting receipts, which encompass Medicare insurance premiums and a variety of other fees and collections, and net interest, which basically reflects the government's interest payments on the national debt. CBO's baseline for offsetting receipts is its estimate of the amount that the government will collect under current laws and policies. Net interest estimates are a function of market interest rates and the amount of federal debt held by the public.

Table A-1.
CBO Projections of Expenditures for Entitlement Programs Assuming Programs Continue
(By fiscal year, in billions of dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Commodity Credit Corporation Fund ^a											
Budget authority	n.a.	n.a.	n.a.	n.a.	4.4	4.5	4.5	4.5	4.5	4.5	4.5
Outlays	n.a.	n.a.	n.a.	n.a.	4.4	4.5	4.5	4.5	4.5	4.5	4.5
Ground Transportation Programs Controlled by Obligation Limitations ^b											
Budget authority	n.a.	n.a.	n.a.	n.a.	n.a.	37.0	37.0	37.0	37.0	37.0	37.0
Outlays	n.a.	n.a.	n.a.	n.a.	n.a.	0	0	0	0	0	0
Ground Transportation Programs Not Subject to Annual Obligation Limitations											
Budget authority	n.a.	n.a.	n.a.	n.a.	n.a.	0.6	0.6	0.6	0.6	0.6	0.6
Outlays	n.a.	n.a.	n.a.	n.a.	n.a.	0.1	0.3	0.5	0.5	0.6	0.6
Air Transportation Programs Controlled by Obligation Limitations ^{b,c}											
Budget authority	1.2	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Outlays	0	0	0	0	0	0	0	0	0	0	0
Family Preservation and Support											
Budget authority	n.a.	n.a.	n.a.	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Outlays	n.a.	n.a.	n.a.	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Rehabilitation Services and Disability Research											
Budget authority	n.a.	2.8	2.9	3.0							
Outlays	n.a.	2.0	2.8	2.9							
Food Stamps											
Budget authority	n.a.	n.a.	n.a.	n.a.	24.0	24.7	25.4	26.1	26.8	27.5	28.2
Outlays	n.a.	n.a.	n.a.	n.a.	23.3	24.7	25.4	26.1	26.8	27.5	28.2
Child Nutrition ^d											
Budget authority	n.a.	n.a.	n.a.	n.a.	n.a.	0.5	0.5	0.6	0.6	0.6	0.6
Outlays	n.a.	n.a.	n.a.	n.a.	n.a.	0.4	0.5	0.6	0.6	0.6	0.6
Child Care Entitlements to States											
Budget authority	n.a.	n.a.	n.a.	n.a.	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Outlays	n.a.	n.a.	n.a.	n.a.	2.3	2.7	2.7	2.7	2.7	2.7	2.7
Temporary Assistance for Needy Families											
Budget authority	n.a.	n.a.	n.a.	n.a.	16.8	16.8	16.8	16.8	16.8	16.8	16.8
Outlays	n.a.	n.a.	n.a.	n.a.	15.3	16.0	16.6	17.3	18.0	18.7	19.4
Veterans' Compensation COLAs											
Budget authority	n.a.	0.4	0.9	1.4	1.9	2.4	3.1	3.5	4.0	4.6	5.2
Outlays	n.a.	0.4	0.8	1.3	1.8	2.3	3.1	3.5	3.7	4.6	5.2
Total											
Budget authority	1.2	2.8	3.3	4.1	52.5	92.0	93.5	94.5	98.6	100.0	101.4
Outlays	0	0.4	0.8	1.4	47.4	51.0	53.5	55.3	59.0	62.1	64.4

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable; COLAs = cost-of-living adjustments.

a. Agricultural commodity price and income supports under the Federal Agriculture Improvement and Reform Act of 1996 (FAIR) generally expire after 2002. Although permanent price support authority under the Agricultural Adjustment Act of 1939 and the Agricultural Act of 1949 would then become effective, section 257(b)(2)(iii) of the Deficit Control Act provides that the baseline must assume continuation of the FAIR provisions.

b. Authorizing legislation provides contract authority, which is counted as mandatory budget authority. However, because spending is subject to obligation limitations specified in annual appropriation acts, outlays are considered discretionary.

c. Authorizing legislation expired March 31, 1999.

d. The expiring Child Nutrition programs are the Summer Food Service program and state administrative expenses.

Baseline Projections

In January, CBO published its baseline projections in *The Economic and Budget Outlook: Fiscal Years 2000-2009*, which described the key factors that influence the federal government's revenues, spending, and deficit or surplus. Since that report was issued, CBO has revised its surplus estimates upward between \$2 billion and \$7 billion for each fiscal year (see Table A-2). CBO now projects that the total budget surplus will be \$111 billion in 1999 and will grow to \$383 billion in 2009.

The Congressional Budget Office generally divides revisions to its estimates into three categories: legislative (those that result from new laws), economic (those that result from revised economic forecasts), and technical (whatever does not fall into the first two categories). Because CBO has not updated its economic forecast and no new legislation has affected projections since January, all changes to the baseline are technical. The technical revisions stem from new information that emerged through late February.

The changes to CBO's January projections result from a downward revision of its outlay estimate. The largest such revision involves the Medicare program, for which CBO reduced its outlay estimate by \$6 billion for 1999 and by lesser amounts for subsequent years. That change reflects an unprecedented period of no growth in Medicare spending, which continues through the early part of 1999 (for more information on Medicare projections, see Chapter 3). In addition, CBO revised downward its projections of Medicaid spending by an average of \$1 billion a year. Projections for other mandatory spending were revised upward for 1999 and 2000 (see Table A-2).

The remaining tables in this appendix (Tables A-3 through A-8) update some of the most widely used information in CBO's January report. Because the revisions are relatively minor, readers seeking a fuller explanation of underlying trends in the budget may refer to that earlier publication.

The most common way to measure the budget's total deficit or surplus is simply to measure the difference between total revenues and spending. However,

Table A-2.
Changes in CBO Projections of Baseline Surplus Since January 1999 (By fiscal year, in billions of dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
January 1999 Baseline Surplus	107	131	151	209	209	234	256	306	333	355	381
Technical Changes											
Revenues	0	0	0	0	0	0	0	0	0	0	0
Outlays											
Discretionary	-1	-2	-1	a	a	a	a	a	a	a	a
Mandatory											
Medicare	-6	-3	-2	-2	-2	-3	-5	-1	-2	a	2
Medicaid	-1	-1	-1	-1	-1	-1	-1	-1	-2	-2	-2
Other	4	3	-1	-1	a	-1	a	-1	-1	-1	-1
Subtotal	-3	-2	-5	-4	-3	-5	-7	-3	-4	-3	-2
Total	3	2	5	4	3	5	7	3	4	3	2
March 1999 Baseline Surplus	111	133	156	212	213	239	263	309	338	358	383

SOURCE: Congressional Budget Office.

a. Less than \$500 million.

the law specifies another way to measure the gap between revenues and spending—the on-budget deficit or surplus—which is shown in Table A-3.

The on-budget deficit or surplus recognizes that the Social Security trust funds and the Postal Service have been given special off-budget status by law. Excluding those programs from the deficit or surplus noticeably changes the fiscal outlook, mainly because Social Security has large amounts of spending and income. The Social Security trust funds currently

have large surpluses because trust fund income—payroll taxes plus the taxes paid on Social Security benefits and the income the trust funds receive from interest on their holdings of Treasury securities—exceed benefits and administrative expenses. In 1999, Social Security income is expected to exceed benefits and administrative payments by \$127 billion; by 2009, the trust fund surplus is expected to climb to \$218 billion, mainly as a result of growing interest income. Consequently, after subtracting the impact of Social Security and the Postal Service, the on-budget measure indi-

Table A-3.
The Budget Outlook Under Current Policies (By fiscal year)

	Actual 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009												
	In Billions of Dollars												
Baseline Total Surplus ^a	69	111	133	156	212	213	239	263	309	338	358	383	
On-Budget Deficit (-) or Surplus (Excluding Social Security and the Postal Service) ^a	-30	-16	-5	11	59	51	68	79	116	134	146	165	
Memorandum:													
Off-Budget Surplus													
Social Security	99	127	137	145	153	162	171	184	193	204	212	218	
Postal Service	b	0	b	b	1	0	0	0	0	0	0	0	
Total	99	127	138	145	153	162	171	184	193	204	212	218	
Total Surplus If Discretionary Spending Is Frozen at the 2002 Level from 2003 to 2009	69	111	133	156	212	228	270	312	377	425	468	516	
As a Percentage of Gross Domestic Product													
Baseline Total Surplus ^a	0.8	1.3	1.5	1.6	2.1	2.1	2.2	2.3	2.6	2.7	2.8	2.8	
On-Budget Deficit (-) or Surplus (Excluding Social Security and the Postal Service) ^a	-0.4	-0.2	-0.1	0.1	0.6	0.5	0.6	0.7	1.0	1.1	1.1	1.2	

SOURCE: Congressional Budget Office.

- a. Assumes that discretionary spending will equal the statutory caps on such spending through 2002 and will grow at the rate of inflation thereafter.
- b. Less than \$500 million.

Table A-4.
CBO Baseline Budget Projections Assuming Compliance with the Discretionary Spending Caps
(By fiscal year)

	Actual 1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
In Billions of Dollars												
Revenues												
Individual income	829	863	893	919	958	990	1,035	1,085	1,138	1,195	1,258	1,323
Corporate income	189	193	188	191	202	214	226	238	250	259	267	273
Social insurance	572	610	640	666	691	717	746	783	816	852	885	923
Other	133	148	148	154	164	170	177	182	188	194	200	208
Total	1,722	1,815	1,870	1,930	2,015	2,091	2,184	2,288	2,393	2,500	2,611	2,727
On-budget	1,306	1,368	1,402	1,443	1,508	1,563	1,634	1,711	1,791	1,871	1,956	2,046
Off-budget	416	446	468	488	506	527	550	577	602	628	654	681
Outlays												
Discretionary spending	555	574	573	573	568	583	598	614	630	646	663	680
Mandatory spending	939	979	1,027	1,081	1,136	1,205	1,273	1,357	1,419	1,505	1,603	1,704
Offsetting receipts	-84	-78	-80	-86	-97	-93	-96	-101	-106	-112	-118	-125
Net interest	243	229	218	207	195	183	170	156	140	123	104	85
Total	1,653	1,704	1,737	1,775	1,802	1,878	1,946	2,025	2,083	2,162	2,253	2,344
On-budget	1,336	1,384	1,407	1,432	1,449	1,512	1,567	1,632	1,675	1,737	1,810	1,880
Off-budget	317	320	330	343	353	366	379	393	408	425	442	464
Deficit (-) or Surplus	69	111	133	156	212	213	239	263	309	338	358	383
On-budget	-30	-16	-5	11	59	51	68	79	116	134	146	165
Off-budget	99	127	138	145	153	162	171	184	193	204	212	218
Debt Held by the Public	3,720	3,628	3,512	3,372	3,176	2,979	2,756	2,508	2,212	1,886	1,540	1,168
As a Percentage of Gross Domestic Product												
Revenues												
Individual income	9.9	9.9	9.8	9.7	9.7	9.6	9.6	9.6	9.6	9.6	9.7	9.8
Corporate income	2.2	2.2	2.1	2.0	2.0	2.1	2.1	2.1	2.1	2.1	2.1	2.0
Social insurance	6.8	7.0	7.0	7.0	7.0	6.9	6.9	6.9	6.9	6.9	6.8	6.8
Other	1.6	1.7	1.6	1.6	1.7	1.6	1.6	1.6	1.6	1.6	1.5	1.5
Total	20.5	20.7	20.6	20.4	20.3	20.2	20.2	20.2	20.2	20.2	20.2	20.2
On-budget	15.5	15.6	15.4	15.2	15.2	15.1	15.1	15.1	15.1	15.1	15.1	15.1
Off-budget	4.9	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.0
Outlays												
Discretionary spending	6.6	6.6	6.3	6.0	5.7	5.6	5.5	5.4	5.3	5.2	5.1	5.0
Mandatory spending	11.2	11.2	11.3	11.4	11.5	11.6	11.7	12.0	12.0	12.1	12.4	12.6
Offsetting receipts	-1.0	-0.9	-0.9	-0.9	-1.0	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Net interest	2.9	2.6	2.4	2.2	2.0	1.8	1.6	1.4	1.2	1.0	0.8	0.6
Total	19.7	19.4	19.1	18.7	18.2	18.1	18.0	17.9	17.6	17.4	17.4	17.3
On-budget	15.9	15.8	15.5	15.1	14.6	14.6	14.5	14.4	14.1	14.0	14.0	13.9
Off-budget	3.8	3.6	3.6	3.6	3.6	3.5	3.5	3.5	3.4	3.4	3.4	3.4
Deficit (-) or Surplus	0.8	1.3	1.5	1.6	2.1	2.1	2.2	2.3	2.6	2.7	2.8	2.8
On-budget	-0.4	-0.2	-0.1	0.1	0.6	0.5	0.6	0.7	1.0	1.1	1.1	1.2
Off-budget	1.2	1.4	1.5	1.5	1.5	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Debt Held by the Public	44.3	41.4	38.6	35.6	32.1	28.8	25.4	22.1	18.7	15.2	11.9	8.6
Memorandum:												
Gross Domestic Product	8,404	8,762	9,095	9,476	9,904	10,358	10,837	11,337	11,855	12,391	12,946	13,521

SOURCE: Congressional Budget Office.

cates deficits through fiscal year 2000 (see Table A-3).

Table A-4 presents federal government revenues by source and outlays by broad category, both in dollars and in relation to gross domestic product (GDP). Under CBO's baseline assumptions, federal revenues are expected to total about \$1.8 trillion in 1999, or 20.7 percent of GDP (their highest level as a percentage of GDP since 1944). Projected revenues fall gradually to 20.2 percent of GDP in 2003 and hold steady at that level through 2009. Total spending is expected to be slightly more than \$1.7 trillion in 1999, or 19.4 percent of GDP. Spending is projected to increase in dollar terms but fall as a percentage of GDP to 17.3 percent in 2009.

Table A-5 presents discretionary outlays by the categories of spending defined by the statutory limits in the Deficit Control Act. CBO's projections of discretionary outlays in that table assume compliance with those limits.

Table A-6 presents spending projections for entitlements and other mandatory programs, by far the largest spending category in the budget. That spending is expected to reach \$979 billion in 1999 and is growing fast. Expenditures for Social Security, Medicare, and Medicaid, which together account for about three-quarters of all mandatory outlays, are fueling that growth.

CBO's baseline projections assume that policymakers will continue to abide by the discretionary spending limits set by the Deficit Control Act through 2002. In the defense, nondefense, violent crime reduction, and overall discretionary categories, separate spending limits apply to budget authority (the authority to commit funds, the basic currency of the appropriation process) and outlays (actual spending). In the highway and mass transit categories, the caps apply only to outlays. Budget authority always precedes actual outlays, with a short interval for fast-spending activities (such as meeting payrolls or providing direct services) and a longer interval for slow-spending activities (such as procuring weapons or building roads and

Table A-5.
CBO Baseline Projections of Discretionary Outlays Assuming Compliance with the Spending Caps
(By fiscal year, in billions of dollars)

	Actual 1998	1999	2000	2001	2002
Defense	270	274	a	a	a
Domestic and International	257	268	a	a	a
Violent Crime Reduction	4	5	6	a	a
Highways	19	22	25	26	27
Mass Transit	4	5	4	5	5
Overall Discretionary ^b	n.a.	n.a.	538	541	536
Total	555	574	573	573	568

SOURCE: Congressional Budget Office.

NOTES: The caps reflect discretionary spending limits as specified by the Office of Management and Budget in the sequestration preview report included in the President's budget, adjusted for CBO's estimate of releases of contingent emergency appropriations for 1999 that the President has not yet designated.

n.a. = not applicable.

a. After the specific cap expires, spending from programs in that category is shown in the "Overall Discretionary" category.

b. In 2000 through 2002, this category comprises defense and nondefense (domestic and international) discretionary spending.

Table A-6.
CBO Baseline Projections of Mandatory Spending (By fiscal year, in billions of dollars)

	Actual 1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Means-Tested Programs												
Medicaid	101	107	117	125	135	146	159	173	188	205	223	243
State Children's Health Insurance	a	1	2	3	4	4	4	4	4	5	5	5
Food Stamps	20	20	21	22	23	24	25	25	26	27	27	28
Supplemental Security Income	27	28	30	31	33	35	37	42	41	40	45	48
Family Support ^b	18	18	19	20	21	22	23	23	24	25	26	27
Veterans' Pensions	3	3	3	3	3	4	4	4	4	3	4	4
Child Nutrition	9	9	9	10	10	11	11	12	13	13	14	14
Earned Income Tax Credit ^c	23	26	27	27	28	28	29	30	30	31	31	32
Student Loans	3	4	5	5	5	5	5	5	5	5	5	6
Foster Care	4	5	5	6	6	7	7	8	8	9	10	10
Total	209	221	237	252	269	285	303	326	344	362	391	417
Non-Means-Tested Programs												
Social Security	376	387	404	423	443	464	487	511	538	566	596	630
Medicare	211	213	229	245	255	278	300	330	344	379	411	444
Subtotal	587	601	633	668	698	742	786	841	882	945	1,007	1,075
Other Retirement and Disability												
Federal civilian ^d	47	49	51	53	55	58	61	64	67	70	73	76
Military	31	32	33	34	35	36	37	38	39	40	42	43
Other	4	5	5	5	5	5	5	5	5	5	5	5
Subtotal	83	86	89	92	95	99	103	107	111	115	119	124
Unemployment Compensation	20	21	23	25	26	28	29	30	31	32	34	35
Deposit Insurance	-4	-4	-2	-1	a	a	1	-1	-1	-1	-1	-1
Other Programs												
Veterans' benefits ^e	21	21	22	23	24	24	25	27	26	25	27	28
Farm price and income supports	9	16	9	7	5	5	5	5	5	5	5	5
Social services	5	5	5	5	5	5	5	5	5	5	5	5
Credit reform liquidating accounts	-8	-6	-7	-8	-7	-7	-8	-7	-8	-8	-8	-8
Universal Service Fund	2	4	6	7	12	12	13	13	13	13	13	13
Other	17	15	13	12	11	12	12	11	11	11	12	12
Subtotal	45	54	47	46	49	51	51	53	52	51	54	54
Total	730	758	789	829	867	920	969	1,031	1,076	1,142	1,213	1,287
Total												
All Mandatory Spending	939	979	1,027	1,081	1,136	1,205	1,273	1,357	1,419	1,505	1,603	1,704

SOURCE: Congressional Budget Office.

NOTE: Spending for the benefit programs shown above generally excludes administrative costs, which are discretionary. Spending for Medicare also excludes premiums, which are considered offsetting receipts.

- a. Less than \$500 million.
- b. Includes Temporary Assistance for Needy Families, Family Support, Aid to Families with Dependent Children, Job Opportunities and Basic Skills, Contingency Fund for State Welfare Programs, Child Care Entitlements to States, and Children's Research and Technical Assistance.
- c. Includes outlays from the child credit enacted in the Taxpayer Relief Act of 1997.
- d. Includes Civil Service, Foreign Service, Coast Guard, other retirement programs, and annuitants' health benefits.
- e. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

Table A-7.**Alternative Amounts of Discretionary Spending for Fiscal Year 2000 Compared with the Spending Caps
(In billions of dollars)**

	Including Amounts for 1999 Emergencies	Excluding Amounts for 1999 Emergencies ^a
Budget Authority		
2000 Cap ^b	536	536
Amount to Preserve 1999 Real Resources		
Defense	290	281
Domestic and international ^c	287	279
Violent crime reduction	<u>6</u>	<u>6</u>
Total ^d	582	566
Amount over 2000 cap	46	29
Amount to Freeze 1999 Dollar Resources ^e		
Defense	281	273
Domestic and international ^c	275	267
Violent crime reduction	<u>6</u>	<u>6</u>
Total ^d	562	546
Amount over 2000 cap	25	10
Outlays		
2000 Cap ^b	573	573
Amount to Preserve 1999 Real Resources		
Defense	286	282
Domestic and international	284	281
Violent crime reduction	5	5
Highways	25	25
Mass transit	<u>5</u>	<u>5</u>
Total	605	598
Amount over 2000 cap	32	25
Amount to Freeze 1999 Dollar Resources		
Defense	280	276
Domestic and international	279	277
Violent crime reduction	5	5
Highways	25	25
Mass transit	<u>5</u>	<u>5</u>
Total	594	587
Amount over 2000 cap	22	15

SOURCE: Congressional Budget Office.

- a. In 1999, \$15.812 billion in appropriations was designated as emergency spending. The totals here exclude the estimated budget authority and outlays that result from assuming that those appropriations are repeated in 2000.
- b. The caps reflect discretionary spending limits as specified by the Office of Management and Budget in the sequestration preview report included in the President's budget, adjusted for CBO's estimate of releases of contingent emergency appropriations for 1999 that the President has not yet designated.
- c. In 1999, an appropriation of \$17.861 billion was provided for the International Monetary Fund to meet a periodic commitment for which funding was last provided in 1993. Such appropriations result in no outlays. The domestic and international totals here exclude the estimated budget authority that results from assuming that the appropriation is repeated in 2000.
- d. This amount does not include mass transit budget authority, which is not subject to a cap. Mass transit budget authority totals \$1.111 billion in 1999.
- e. Amounts needed to freeze 1999 dollar resources have no adjustment for inflation.

other infrastructure). In cases in which the spending limits restrict both budget authority and outlays, the more stringent of the two prevails.

Table A-7 compares alternative projections of discretionary spending for fiscal year 2000 with the

spending caps for that year. The first alternative compares the level of funding necessary to preserve 1999 real resources in 2000 with the spending caps. Two scenarios are examined under that alternative. The first scenario assumes that appropriations designated as emergency spending in 1999 are provided again in

Table A-8.
CBO Baseline Projections of Interest Costs and Federal Debt (By fiscal year)

	Actual 1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Net Interest Outlays (Billions of dollars)												
Interest on Public Debt (Gross interest) ^a	364	356	350	347	344	341	339	336	332	327	321	315
Interest Received by Trust Funds												
Social Security	-47	-52	-58	-64	-71	-79	-87	-96	-105	-115	-126	-137
Other trust funds ^b	<u>-67</u>	<u>-67</u>	<u>-68</u>	<u>-69</u>	<u>-71</u>	<u>-73</u>	<u>-75</u>	<u>-77</u>	<u>-79</u>	<u>-81</u>	<u>-82</u>	<u>-84</u>
Subtotal	-114	-119	-125	-133	-142	-152	-162	-173	-184	-196	-209	-221
Other Interest ^c	<u>-7</u>	<u>-8</u>	<u>-6</u>	<u>-6</u>	<u>-7</u>	<u>-7</u>	<u>-7</u>	<u>-8</u>	<u>-8</u>	<u>-8</u>	<u>-8</u>	<u>-8</u>
Total	243	229	218	207	195	183	170	156	140	123	104	85
Federal Debt at the End of the Year (Billions of dollars)												
Gross Federal Debt	5,479	5,584	5,676	5,748	5,776	5,812	5,828	5,828	5,789	5,729	5,647	5,542
Debt Held by Government Accounts												
Social Security	730	857	994	1,139	1,292	1,453	1,624	1,808	2,001	2,205	2,417	2,634
Other accounts ^b	<u>1,029</u>	<u>1,099</u>	<u>1,170</u>	<u>1,237</u>	<u>1,309</u>	<u>1,380</u>	<u>1,448</u>	<u>1,513</u>	<u>1,576</u>	<u>1,638</u>	<u>1,691</u>	<u>1,739</u>
Subtotal	1,759	1,956	2,164	2,376	2,601	2,833	3,072	3,321	3,577	3,842	4,107	4,373
Debt Held by the Public	3,720	3,628	3,512	3,372	3,176	2,979	2,756	2,508	2,212	1,886	1,540	1,168
Debt Subject to Limit ^d	5,439	5,545	5,638	5,710	5,740	5,776	5,792	5,794	5,756	5,696	5,615	5,510
Federal Debt as a Percentage of Gross Domestic Product												
Debt Held by the Public	44.3	41.4	38.6	35.6	32.1	28.8	25.4	22.1	18.7	15.2	11.9	8.6

SOURCE: Congressional Budget Office.

NOTE: Projections of interest and debt assume that discretionary spending will equal the statutory caps that are in effect through 2002 and will grow at the rate of inflation thereafter.

- a. Excludes interest costs of debt issued by agencies other than the Treasury (primarily the Tennessee Valley Authority).
- b. Mainly Civil Service Retirement, Military Retirement, Medicare, unemployment insurance, and the Highway and the Airport and Airway Trust Funds.
- c. Mainly interest on loans to the public.
- d. Differs from the gross federal debt primarily because most debt issued by agencies other than the Treasury is excluded from the debt limit. The current debt limit is \$5,950 billion.

2000 but are not given an emergency designation. Under the first scenario, projected budget authority and outlays exceed the caps by \$46 billion and \$32 billion, respectively. The second scenario assumes that the appropriations designated as emergency spending in 1999 are not provided in 2000. Under the second scenario, projected budget authority and outlays exceed the 1999 amount by \$29 billion and \$25 billion, respectively.

The second alternative compares the level of funding necessary to freeze 1999 dollar resources in 2000 with the spending caps. Two scenarios are also examined under the second alternative. The first scenario assumes that appropriations designated as emergency spending in 1999 are provided again in 2000 but are not given an emergency designation, in which case projected budget authority and outlays exceed the caps by \$25 billion and \$22 billion, respectively. The second scenario assumes that the appropriations designated as emergency spending in 1999 are not provided in 2000, in which case projected budget authority and outlays exceed the 1999 amount by \$10 billion and \$15 billion, respectively.

Interest costs are a significant portion of the federal budget—about 15 percent of all federal spending today. Under CBO's baseline projections, which assume stable interest rates through 2009, interest payments will decline to less than 4 percent of federal outlays by that year. In dollar terms, net interest will fall from \$229 billion in 1999 to \$85 billion in 2009 (see Table

A-8). Measured as a percentage of GDP, interest costs are expected to decline from 2.6 percent in 1999 to 0.6 percent by 2009 (see Table A-4 on page 69).

Debt held by the public is the amount of money that the federal government has borrowed—by selling securities—to finance all of the deficits (less any surpluses) accumulated over time (see Table A-8). Under CBO's current baseline forecast, debt held by the public is estimated to decline from \$3.6 trillion in 1999 (41.4 percent of GDP) to \$1.2 trillion in 2009 (8.6 percent of GDP).

Gross federal debt consists of debt held by the public and debt issued to government accounts. Most of the latter type of debt is held by trust funds, the largest of which are the Social Security and federal civilian employee retirement funds. Because the Treasury handles investments by trust funds and other government accounts, purchases and sales of such securities do not flow through the credit markets. Therefore, interest on those securities is considered to be an intragovernmental transfer.

CBO expects gross federal debt to be \$5.6 trillion in 1999. Since trust fund balances are projected to grow more rapidly than total budget surpluses through 2005, gross federal debt will continue to grow until it reaches \$5.8 trillion in that year. Thereafter, gross federal debt is expected to decline and, by 2009, is projected to be \$5.5 trillion.

Appendix B

Outlay Estimates for National Defense

The Congressional Budget Office (CBO) estimates that under the Administration's request for defense discretionary programs for fiscal year 2000, outlays will be nearly \$10 billion higher than forecast by the Office of Management and Budget (OMB). An estimating difference in that direction is not unusual. Over the 1994-1998 period, CBO's estimates of defense outlays have consistently exceeded those of the Administration. But the problem with CBO's estimates has not been that they were too high. On the contrary, they were not high enough, and actual outlays exceeded CBO's estimates by a few billion dollars each year.

Accuracy of Estimates of Defense Outlays

In every year since 1993, actual outlays have exceeded CBO's estimates of discretionary spending for the Department of Defense (DoD). For all defense activities of the federal government, including the atomic energy activities of the Department of Energy, actual outlays have surpassed CBO's estimates since 1994. Nevertheless, the absolute errors (that is, without regard to sign) have been relatively small in percentage terms—ranging from 0.1 percent to 2.4 percent and averaging about 1 percent over the past six years (see Table B-1). More information on the accuracy of the estimates can be found in CBO's October 1998 memorandum *An Analysis of CBO's Outlay Estimates for Appropriation Bills, Fiscal Years 1993-1997*.

Although estimating differences between CBO and the Administration are common, the \$9.6 billion difference for the 2000 budget request is almost twice as great as the largest difference in recent years. Over the 1993-1997 period, differences based on the budget request were relatively small, averaging about \$1.5 billion annually. For the 1998 and 1999 requests, however, they grew larger, increasing to \$5.7 billion and \$3.7 billion, respectively (see Table B-2).

The size of the estimating differences for the 1998 and 1999 budget requests generated a debate about whose estimates were more accurate. OMB has now published its estimates for recently enacted appropriation bills, and as a result, the accuracy of CBO's and OMB's estimates can be analyzed. Table B-3 compares each agency's original estimates of enacted appropriations with actual spending in 1997 and 1998 and the most up-to-date forecasts for 1999. Those original estimates, made at the time appropriation bills were enacted, include the effects of regular and supplemental appropriations as well as any rescissions or transfers.

For 1997, actual defense spending was \$6.6 billion higher than CBO's estimate of \$265.1 billion. CBO's estimate, however, was more accurate than the Administration's, since actual outlays exceeded OMB's estimate by \$7.4 billion. Although actual spending exceeded both agencies' estimates once again in 1998, CBO's error totaled only \$1.8 billion, whereas OMB's comparable error—\$5.8 billion—was over three times as great.

For 1999, CBO's most recent examination of outlays suggests that spending will ultimately total \$274.2 billion. In contrast, the Administration's revised total is \$277.5 billion, which indicates that it now believes actual spending will be roughly \$8 billion more than its original estimate. In either case, CBO's original estimate of \$275.2 billion would be closer to the mark than the Administration's.

Estimating Differences for 2000

The \$9.6 billion estimating difference between CBO and the Administration has two parts. The first amounts to about \$6 billion and stems from different analytic judgments about spendout rates of appropriations for 2000 and disbursement rates for unexpended balances from prior years. Such issues have been characteristic of disagreements about previous budget requests. However, the difference this year is larger than those in recent years. The remaining \$3.6 billion difference on this year's estimate can be traced to different estimates for an assortment of special factors shown in Table B-4.

Analytic Judgments About Spending Patterns

After the end of each fiscal year, CBO reviews the data for that year to determine whether any changes are necessary to improve its estimates. CBO uses accounting documents provided by the Administration to estimate unexpended balances from prior-year appropriations. Analysts also review the outlay figures for each account to assess whether any change in spendout rates is called for. Finally, when the Administration releases its budget, CBO carefully reviews its projections to ensure that it has a sound basis for any significant estimating differences. Thus, CBO's estimates are based on accounting information provided by the Administration and reflect any rescissions, deferrals, or transfers.

Analysts can easily reach different conclusions about projections of defense spending. The Adminis-

tration, however, has a strong incentive to estimate relatively low outlays for the year in which it is requesting funds because the outlay caps in the Deficit Control Act have been more constraining than the limits on budget authority. Thus, the lower the estimate of outlays, the better the chance of obtaining the requested level of budget authority.

In fact, since 1989, the National Defense Authorization Act has required CBO and OMB to issue a joint report on the outlay rates and estimates of spending from prior appropriations that the agencies intend to use during the upcoming budget cycle.¹ The clear purpose of that law is to minimize differences between CBO's and OMB's estimates. It has led to extensive discussions between staff from CBO and the Administration, with the Administration's analysts consistently arguing for lower estimates and CBO's analysts arguing for higher ones. Estimating differences before 1989 had, at times, been large. In the early and mid-1990s, those differences were relatively small. For budget requests in the late 1990s, they have increased once more. That pattern continues for fiscal year 2000: CBO's analysis yields an estimate of outlays that exceeds the Administration's by about \$6 billion solely on the basis of differing spendout rates for new appropriations and disbursement rates for unexpended balances.

Other Factors

In addition, CBO and the Administration have different estimates regarding the impact on outlays of certain policy and budgetary initiatives. The policy initiatives center on revisions to policies for paying contractors, the cancellation of about \$1.7 billion in enacted appropriations, and the availability for obligation of certain emergency funding. The budgetary initiatives cover changes in accounting methods for funding to maintain real property and to construct new facilities. Those factors combine to produce a \$3.6 billion difference between CBO's and the Administration's outlay estimates for 2000.

1. The initial requirement was part of the National Defense Authorization Act for Fiscal Years 1990 and 1991, enacted on November 29, 1989. The current requirement is part of the National Defense Authorization Act for Fiscal Years 1992 and 1993, as amended.

Payments to Contractors. DoD plans to change its procedures for paying certain contractors. Specifically, it plans to deny interim or progress payments for contracts between \$1 million and \$2 million in value. Thus, instead of receiving periodic payments over the course of the contract, contractors will not receive payment until the final product is delivered. Under DoD's current policy, contracts under \$1 million are not eligible for progress payments unless a company receives a waiver because of special need. Under the new policy, which will be in place by the start of 2000, the threshold will be raised to \$2 million, but the same waivers will be available. The Administration estimates that this action will cause a one-time reduction in outlays of \$1.5 billion in 2000. CBO estimates that the reduction will total only about \$0.3 billion.

Several factors will limit the new policy's effect on outlays in 2000. First, the policy will apply only to large businesses and only to new contracts; that is, payments under existing contracts will remain unchanged. Next, payments for some contracts awarded early in 2000 will simply be delayed until later in the year, when final products are delivered. In those instances, outlays in 2000 will remain unaffected—only the distribution of outlays over the fiscal year will change. Finally, companies that can demonstrate a special need will still be eligible for a waiver.

The Administration's estimate assumes that in 2000, the higher threshold will make more than \$4 billion of contracts ineligible for progress payments. After accounting for some of the factors listed above as well as the spending patterns of contracts subject to progress payments, the Administration estimates that the new threshold will lower outlays in 2000 by \$1.5 billion. It also assumes that this new policy will affect spending in various parts of the DoD budget—namely, the operation and maintenance (O&M), procurement, research and development, and working capital fund accounts.

Based on information from DoD offices that help administer contracts as well as a 1993 DoD report, CBO expects that less than \$0.5 billion in contracts will become ineligible for progress payments in 2000,

resulting in a \$0.3 billion drop in outlays.² Moreover, CBO expects that the only significant budgetary impact will occur in the procurement accounts.

Cancellation of Appropriations. The budget contains a proposal to cancel up to \$1.7 billion of enacted budget authority. The proposal, which would give the Secretary of Defense the discretion to select the projects and accounts for cancellation, would reduce outlays by about \$0.9 billion according to OMB's and DoD's estimates but only by about \$0.4 billion according to CBO's estimate. The estimates differ because CBO assumes that DoD would not cancel appropriations in military personnel and O&M accounts because the activities supported by those funds have a high priority. On that basis, cancellations would be most likely to occur in weapons procurement accounts, in which the impact on outlays in 2000 would be relatively small.

Emergency Funding. In 1999, the Congress provided \$7.8 billion in emergency appropriations to DoD. Some of those funds were immediately released to DoD, and others were contingent on the President's declaring that they would be used for emergency needs. In its budget, the Administration includes spending only from those DoD funds that had been released when the budget was submitted. In contrast, CBO anticipates that the funding will be released and estimates that outlays in 2000 will be about \$0.6 billion higher than the Administration's estimate for that reason.

Maintenance of Real Property. The Administration proposes to fund real property maintenance (RPMA) in a separate account instead of combining it with funding for other activities in the O&M accounts as in the past. Reclassifying that funding would have no impact on DoD outlays, but the Administration's outlay estimate for 2000 is reduced by almost \$1 billion as a result of this change. Although the budget request recognizes that RPMA funding spends out slowly, it fails to raise the outlay rates for the O&M

2. The estimate is based in part on information in Department of Defense, *Report on Progress Payment Rates* (April 1993).

accounts to reflect the fact that the slow-spending RPMA activities would no longer be funded from those accounts. In contrast, CBO's estimate assumes that after the reclassification, outlay rates for O&M would rise to reflect the fact that changing the account structure would have no net effect on outlays.

Construction of New Facilities. The Administration requests about \$2.3 billion in 2000 to fund the obligations that normally occur in the first year of certain construction projects. The Administration also proposes to fund the completion of the projects by requesting about \$3.0 billion as advance appropriations that would be counted as budget authority in 2001. Under previous practices, all the necessary funding

would have been provided in 2000. Splitting the budget authority into two pieces, however, is unlikely to change the pace of obligations and outlays. Nevertheless, OMB and DoD estimate outlays using spendout rates that apply when all budget authority for a project is charged to the initial fiscal year. That is, they treat each year's appropriation as if it was to fund two years worth of projects rather than one. Consequently, the estimate understates the likely effect on outlays. CBO derives its estimate by applying historical spendout rates to the full amount of budget authority (\$5.3 billion) for the relevant projects. As a result, CBO's estimates of outlays for military construction and family housing exceed the Administration's estimates by about \$0.4 billion.

Table B-1.
Comparison of Actual and CBO's Estimated Outlays for National Defense Appropriations,
Fiscal Years 1993-1998

Category	1993	1994	1995	1996	1997	1998
Actual Minus Estimate (Billions of dollars)						
Department of Defense						
Military personnel	-1.8	2.4	0.2	-0.5	-0.3	-0.6
Procurement	2.3	0.6	0.1	0.6	2.4	3.4
O&M and working capital funds ^a	2.3	3.9	b	-3.0	2.9	-2.0
RDT&E	-0.5	-1.2	-0.6	1.8	1.8	1.7
Other	<u>-1.7</u>	<u>-0.2</u>	<u>2.2</u>	<u>1.7</u>	<u>-0.5</u>	<u>-0.2</u>
Subtotal	0.5	5.5	1.9	0.6	6.3	2.4
Atomic Energy	-0.8	0.8	1.4	1.2	0.2	-0.6
Other	<u>-0.1</u>	<u>b</u>	<u>b</u>	<u>b</u>	<u>b</u>	<u>b</u>
All National Defense Appropriations	-0.4	6.3	3.3	1.8	6.6	1.8
Actual Minus Estimate (Percentage of actual outlays)						
Department of Defense						
Military personnel	-2	3	c	-1	c	-1
Procurement	3	1	c	1	5	7
O&M and working capital funds ^a	3	4	c	-3	3	-2
RDT&E	-1	-4	-2	5	5	5
Other	-22	-2	21	15	-5	-2
All Department of Defense	c	2	1	c	2	1
Atomic Energy	-8	6	12	10	2	-6
Other	-6	c	-7	-6	-2	3
All National Defense Appropriations	c	2	1	1	2	1

SOURCE: Congressional Budget Office.

NOTE: O&M = operation and maintenance; RDT&E = research, development, test, and evaluation.

- a. The O&M accounts are the main users of DoD's working capital funds. Thus, outlays in those accounts are related, and their sum is more meaningful for this analysis than their respective parts.
- b. Less than \$50 million.
- c. Less than 0.5 percent.

Table B-2.

Differences Between CBO's and OMB's Estimates of Outlays from the President's Budget Requests for National Defense Discretionary Programs, Fiscal Years 1993-2000 (In billions of dollars)

Fiscal Year	CBO	OMB	Difference
1993	293.5	292.0	1.5
1994	279.3	277.7	1.6
1995	271.7	271.1	0.6
1996	263.7	262.2	1.5
1997	261.6	259.4	2.2
1998	265.8	260.1	5.7
1999	270.2	266.5	3.7
2000	284.5	274.8	9.6

SOURCES: Congressional Budget Office; Office of Management and Budget.

Table B-3.
Accuracy of CBO's and OMB's Estimates of National Defense Discretionary Outlays
(By fiscal year, in billions of dollars)

	1997	1998	1999 ^a
Estimate of Appropriation Action			
CBO	265.1	268.4	275.2
OMB	264.3	264.4	268.9
Actual	271.7	270.2	N.A.
Current Estimate			
CBO	n.a.	n.a.	274.2
OMB	n.a.	n.a.	277.5
Difference (Actual or current estimate minus original estimate)			
CBO	6.6	1.8	-1.0
OMB	7.4	5.8	8.6

SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTE: N.A. = not available; n.a. = not applicable.

- a. The release of certain 1999 supplemental appropriations was made contingent on the President's declaring that those funds would be used for emergency purposes. At the time these estimates were prepared, some of those funds had not been released. CBO expects that those appropriations will be released and therefore includes outlays from those funds in its estimates. OMB, however, did not do that. Had the unreleased appropriations been included in the Administration's figures, its original estimate of outlays would have been roughly \$1.5 billion to \$2.5 billion higher, and its current estimate would have been roughly \$1 billion to \$2 billion higher.

Table B-4.
Sources of Differences Between CBO's and OMB's Estimates of National Defense Discretionary Outlays for Fiscal Year 2000 (In billions of dollars)

	Differing Judgments About Spending Rates	Progress Payments	Cancel-lation Authority	1999 Budget Authority for Emergencies	Real Property Maintenance	Construc-tion Projects	Total Difference
Department of Defense							
Military personnel	0.1	0	0	0	0	0	0.1
Operations							
Operation and maintenance	3.0	0.4	0	0.5	1.0	0	4.9
Working capital funds	0.5	0.4	0	0	0	0	0.9
Subtotal	3.5	0.7	0	0.5	1.0	0	5.8
Procurement	1.7	-0.1	0	0	0	0	1.7
RDT&E	0.6	0.5	0	0.1	0	0	1.2
Military construction and family housing	0.1	0	0	0	0	0.4	0.5
Other	0	0	0.5	0	0	0	0.5
Total	6.0	1.2	0.5	0.6	1.0	0.4	9.7
Atomic Energy	-0.1	0	0	0	0	0	-0.1
All National Defense	6.0	1.2	0.5	0.6	1.0	0.4	9.6

SOURCE: Congressional Budget Office.

NOTE: RDT&E = research, development, test, and evaluation.

Appendix C

Major Contributors to the Revenue and Spending Projections

The following Congressional Budget Office analysts prepared the revenue and spending projections in this report:

Revenue Projections

Mark Booth	Individual income taxes
Hester Grippando	Customs duties, miscellaneous receipts
Carolyn Lynch	Corporate income taxes, Federal Reserve System earnings
Noah Meyerson	Social insurance taxes
Larry Ozanne	Capital gains realizations
John Sabelhaus	Estate and gift taxes
Sean Schofield	Excise taxes
David Weiner	Individual income taxes

Spending Projections

Defense, International Affairs, and Veterans' Affairs

Shawn Bishop	Veterans' health care, military health care
Kent Christensen	Defense (military construction, base closures, defense outlay estimates)
Jeannette Deshong	Defense (military personnel, NATO expansion, and other international agreements)
Sunita D'Monte	International affairs (conduct of foreign affairs and information exchange activities), veterans' housing
Richard L. Fernandez	Defense (effects of REDUX on retention of enlisted personnel)
Raymond Hall	Defense (steady-state costs of Navy weapons, missile defenses, atomic energy defense)
Sarah T. Jennings	Defense (military retirement and veterans' education)
Lane Pierrot	Defense (aging of equipment)

Charles Riemann	Veterans' compensation and pensions
Dawn Sauter	Steady-state costs of weapons, intelligence programs, defense acquisition reform
Marvin M. Smith	Defense (effects of REDUX on retention of officers)
JoAnn Vines	Defense (steady-state costs of tactical air forces, bombers, and Army systems)
Joseph Whitehill	International affairs (development, security, international financial institutions)

Health

Chuck Betley	Medicare, Federal Employees Health Benefits, Public Health Service
Michael Birnbaum	Medicare Part B, Public Health Service
Julia Christensen	Medicare Part B, Federal Employees Health Benefits, Public Health Service
Jeanne De Sa	Medicaid, State Children's Health Insurance Program
Cynthia Dudzinski	Medicare, Public Health Service
Dorothy Rosenbaum	Medicaid, State Children's Health Insurance Program, tobacco

Human Resources

Valerie Baxter	Food Stamps, child nutrition, child care
Sheila Dacey	Child Support Enforcement, Temporary Assistance for Needy Families, foster care, Social Security
Deborah Kalcevic	Education
Sean McCluskie	Education, foster care
Josh O'Hara	Pell grants, Pension Benefit Guaranty Corporation, education
Carla Pedone	Housing assistance, Social Security
Eric Rollins	Federal civilian retirement, Supplemental Security Income
Kathy Ruffing	Social Security
Christi Hawley Sadoti	Unemployment insurance, training programs, aging programs, arts and humanities

Natural and Physical Resources

Coleman Bazelon	Spectrum auction receipts
Gary Brown	Water resources, other natural resources, regional development
Kim Cawley	Energy, pollution control and abatement, Universal Service Fund
Lisa Cash Driskill	Highways
Mark Grabowicz	Justice, Postal Service
Kathleen Gramp	Energy, science and space, spectrum auction receipts
Mark Hadley	Commerce, credit unions, Small Business Administration
Victoria Heid	Conservation and land management, Outer Continental Shelf receipts, air transportation
David Hull	Agriculture
Craig Jagger	Agriculture
James Langley	Agriculture
Mary Maginniss	Deposit insurance, legislative branch
Susanne Mehlman	Justice, Federal Housing Administration and other housing credit
Marjorie Miller	Highways, AMTRAK, mass transit
James O'Keeffe	Surface transportation
Deborah Reis	Recreation, water transportation, community development
John Righter	General government, Indian affairs, Federal Emergency Management Agency

Other

Janet Airis	Appropriation bills
Edward Blau	Appropriation bills
Jodi Capps	Appropriation bills
Betty Embrey	Appropriation bills
Kenneth Farris	Computer support
Mary Froehlich	Computer support
Vernon Hammett	Computer support
Jeffrey Holland	Net interest on the public debt
Catherine Little	Appropriation bills
Taman Morris	Other interest
Robert Sempsey	Appropriation bills
Jennifer Winkler	National income and product accounts